In all types of business transactions, also referred to as memorandums of understanding, agreements in principle, or commitment letters, letters of intent aim to memorialize the general terms of a deal, facilitate future negotiations, and smooth the path toward a definitive agreement. If not carefully thought out and meticulously drafted, however, a letter of intent can prove disastrous.

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Letters of intent are often used to outline the basic terms of a deal, including the price, the terms of payment, and the conditions of the sale. They are usually signed by both parties and are binding unless the parties agree otherwise. Letters of intent are often used in the context of mergers and acquisitions, where the parties are trying to reach an agreement on the terms of the deal before the details are worked out.

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Letters of Intent: Friend Or Foe?

The use of letters of intent continues to be widespread in all types of business transactions. Also referred to as memorandums of understanding, agreements in principle, or commitment letters, letters of intent aim to memorialize the general terms of a deal, provide order and structure to negotiations, and smooth the path toward a definitive agreement. If not carefully thought out and meticulously drafted, however, a letter of intent can prove disastrous.

A letter of intent can prove disastrous if not carefully thought out and meticulously drafted. There are numerous advantages to entering into a letter of intent prior to finalizing a business transaction. Letters of intent provide some assurance that the parties possess a legitimate interest in seeing a deal through to closing. Letters of intent also set the ground rules for negotiations and provide a framework for the final agreement. Another major benefit of entering into a letter of intent is the potential to save a great deal of time and money. Letters of intent flush out preliminary issues and allow them to be resolved prior to negotiating the finer points of the final agreement. Because preliminary matters are out of the way, negotiations can be more focused and straightforward, and a final agreement can be reached more quickly. Letters of intent also expose situations in which the parties’ desires are too divergent, allowing them to walk away without wasting time and incurring substantial expense in protracted negotiations.

Other positive aspects of letters of intent include creating a feeling of moral obligation to see the deal through to conclusion, providing order and structure to negotiations, avoiding ambiguity and other perils of verbal communications, and making it easier for the purchasing party to obtain financing.

Nonwithstanding the foregoing benefits, there are many potential pitfalls associated with letters of intent. Delays are a problem frequently encountered when using a letter of intent. While originally designed to save time, negotiating a letter of intent can actually end up wasting valuable hours. Time spent drafting the letter of intent may be more effectively spent drafting the final agreement. Also, if the parties become wrapped up in the minute details before working out more universal issues, they may hinder their respective positions and prematurely shut down negotiations. Excessive expense can also make letters of intent an unattractive option. Unless the underlying transaction is a fairly complex deal, a party may end up spending more money to draft a comprehensive letter of intent and force the court to a jury to interpret the parties’ intentions. In construing the letter of intent, a court will likely examine the wording of the letter, consider the context of negotiations, review the performance of any obligations, and weigh any open issues. The court may also apply what it deems to be commercially reasonable terms to the letter. The end result of this process could leave the parties stuck with a deal that was not completely negotiated and that has missing or unexpected material terms.

For example, in *Logan v. D.W. Sivers Co.*, 169 P.3d 1255 (Or. 2007), the parties entered into a letter of intent to establish the framework for the sale of a piece of property. Twenty-one days after the letter of intent was signed, the Seller sold the property to a third party. The Purchaser filed suit for breach of the non-solicitation provision. The Supreme Court of Oregon held that the Seller was bound by the terms of the non-solicitation provision. The court found that the following provision clearly created a binding promise with respect to non-solicitation of third parties:

\[
\text{(7th Cir.1988), a case cited by the Seller for Tenterman v. Allegheny Inter., Inc. (7th Cir.1988), a case cited by the Seller for}
\]

The court then rejected the Seller’s argument that the lack of commitment by the parties to the negotiations released it from the non-solicitation clause. In reaching its decision, the Court declined to apply *Feldman v. Allegheny Inter., Inc.*, 850 F.3d 1217 (7th Cir.1988), a case cited by the Seller for the proposition that the non-solicitation

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provision was operative only as long as both parties elected to pursue the transaction. The court noted that unlike the non-solicitation clause in Feldman, the non-solicitation provision at issue was not couched in terms of the parties’ continued commitment to negotiations but, instead, spoke in terms of a specific period of time of 60 days. Thus, the Seller’s sale of the property to a third party within the 60 day period constituted a breach of the non-solicitation provision. Lastly, the court refused to excuse the Seller from the non-solicitation provision due to the Purchaser’s failure to provide a draft Purchase and Sales Agreement within 15 days after the execution of the letter of intent. The court ruled that the language used in the letter of intent, “approximately 15 days,” was ambiguous and that it was not unreasonable for the jury to conclude that delivery of the draft on day 21 was timely.

Notwithstanding its finding that the Seller breached the non-solicitation provision of the letter of intent, the court held that because the non-binding terms of the letter of intent did not require the Seller to sell the property to the Purchaser, the Purchaser’s proper measure of damages was the expense incurred in negotiating the final deal and not losses which resulted from the lack of sales. Unfortunately, both parties ended up with the fuzzy end of the lollipop due to a poorly drafted letter of intent. Undoubtedly, both sides incurred substantial expense and expended valuable time to see this matter through trial and appeal. Had the provision regarding the delivery of the draft Purchase and Sales agreement been specific instead of speaking in terms of approximate days, the Purchaser would have almost certainly delivered the draft in a timely fashion, and the Seller would not have sought a buyer elsewhere. Had the Seller understood that the 60 day provision would bind him to deal solely with the Purchaser through periods of inactivity, he would have likely requested a change in terms or even walked away from the deal. Had the Purchaser realized that his damages would be limited due to the non-binding nature of the letter, he would have surely requested a liquidated damages provision or would have had the opportunity to make a cost benefit analysis of filing a lawsuit. In summary, if more thought and care had been put into drafting the letter of intent, the parties would have reached a final agreement or would have realized that they were too far apart to continue negotiations. Either way, they would have avoided a costly trip to the courthouse.

Because most parties feel more comfortable having the basic terms of an agreement memorialized early in the negotiations process and because a letter of intent does offer numerous benefits, it is improbable that the use of letters of intent will fall by the wayside. However, the existence of risks such as those discussed above should serve as a reminder that the drafting of a letter of intent should not be taken lightly. While not an exhaustive list, the following guidelines will help you capitalize on the benefits and reduce the pitfalls presented by letters of intent:

- Be brief.
- Be definite and precise, but refrain from including specific details of essential terms unless there is an intent to be bound.
- Include an express statement that the letter is not binding or that it contains both binding and non-binding provisions; clearly label any provision intended to be binding and set it apart from other provisions. Be specific when setting forth obligations in binding provisions (i.e., avoid ambiguous language like “approximately 15 days”).

Examples of binding provisions: confidentiality regarding negotiations, confidentiality of information contained in due diligence materials, no-shop or break-up provisions, anti-chabbling provisions, non-solicitation of employees and/or customers, notification of competing bids, payment of certain fees, termination triggers, and limitations of public disclosure. For some of the above, you may want to consider entering into a separate agreement that will survive the letter of intent.

- Examples of nonbinding provisions: structure of the deal, purchase price, representations and warranties, conditions to closing.

- Include other key provisions such as:
  - Details regarding the transaction including a recitation of the parties involved, a description of the transaction itself (purchase of business, settlement, assets being acquired), particulars of the transactions structure.
  - Obligation to adhere to the agreement in good faith.
  - Terms of payment.
  - Time limits for completion of obligations under terms of the letter.
  - Time limits for entering into a final agreement and/or closing.
  - Important covenants and key provisions (see examples of binding and non-binding provisions listed above).
  - Details on how the parties will carry out obligations or will otherwise operate between the signing of the letter of intent and the execution of the final agreement.
  - Indemnification provisions.
  - Provisions regarding governing law and jurisdiction and/or arbitration in lieu of legal action.
  - Representations and warranties.
  - Terms and conditions of any side agreements.
  - Use a signature line for all parties intended to be bound by the letter of intent.

- Steps to take to meet your obligations under the letter of intent.


Written by Charles Johnson and Kim Coggin