LETTERS OF INTENT: MAJOR CONSIDERATIONS

By Vaughn Buffalo

LOI stands for Letter of Intent. It is a sketch of the business transaction that the parties will enter into. It is a roadmap and a guide that makes sure everyone is on the same page. Sometimes, business people don't want to expend the time energy and expense to create a LOI if a definitive agreement is being drafted. It is seen as a double expense. Why pay a lawyer twice? Once for the practice run and another for the real deal.

I don't advocate that generally. Skipping the LOI provides a short-term cost savings that sacrifices long-term efficiencies. Plus, there is a certain amount of momentum that the parties generate by actually signing an agreement in principle. It's hard enough to come to agreement, might as well generate as much early momentum as possible. I do think it is important for the business people to lead the way here keeping the focus on the main business points. Attorneys might angle for legal advantage in the minutiae while drafting the LOI which is not very helpful.

The LOI is made of 2 parts: the non-binding part and the binding part, meaning legally enforceable and not legally enforceable. The non-binding portion deals with the important stuff—price and structure and steps to take to get the deal done as well as general responsibilities. The binding portion deals with technicalities, but by no means unimportant—exclusivity, confidentiality and governing law.

Be aware that even though the non-binding part carries no legal force, it does have moral force. A party could not sign an LOI stating price X for the deal and then right before closing demand a major change such as the buyer dropping the price by 20% (neither could the seller raise the price by 20%), and expect to close the deal. But neither party could sue the other in such a case either. Just know that a common objection is "that wasn't in the LOI".

To get a little more specific, the non-binding sections generally are as follows:

- **Price**—Consideration to be paid for the company or assets
- **Structure**—Whether the transaction is an asset, stock or merger transaction. Unfortunately, explaining the differences between each type of transaction is too involved for the scope of this article.
- **Working Capital Adjustments**—Sketching out the formula to use for such an adjustment and whether there will be holdbacks (money withheld) in order to protect the buyer if the seller doesn't pay any of their receivables and takes all the cash right before closing.
- **Installment Payments**—whether there will be payments made to seller after the closing over time.
- **Contingent Payments**—whether there will be a bonus provided to the seller in case the company or assets bought perform extremely well.
- **Type of Closing**—whether this will be a simultaneously signing and closing (meaning all money paid and transfer happening all at the same time) or whether this will have a signing and subsequent closing (often seen in real estate deals where people sign and sale contract and provide some earnest money at such time, but the real closing happens later). Again, the scope of this article is too short to address these, but suffice it to say that the simultaneous sign and close is much simpler than the other type of closing.
- **Other Agreements**—If there are employment, consulting, lease or other agreements that are part of the transaction, the LOI typically refers them and may provide important provisions such term, and salary, etc.

The binding sections typically are:

- **Exclusivity Period**—This is the time that buyer and seller agree to only talk to each other to complete a deal. The period can last anywhere from 90 days to 150 days. My experience is that everything takes longer than one would think. But for a typical small M&A deal and it is rare that it is complete within 60 days. Whereas initially stating 180 days seems like the parties are not focused. Often the parties say 90 days, and then the deadline gets mutually extended and extended until the deal is done.
- **Confidentiality**—this is a very important provision that may be addressed in the LOI or may have a standalone agreement that address these issues.
- **Contingencies on the Transaction**—Often the Buyer will need board approval to close the deal and will make the transaction subject to due diligence. For example, if the buyer is looking into the records of the seller (meaning conducting due diligence) and it uncovers a large litigation that the seller is subject to, then the buyer could walk away from the deal without breaching the exclusivity clause. Or, if the buyer still wants to do the deal, but the board says no, then again buyer can step away without fear of breach.

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