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CORPORATE

Business Courtship and the Value of Letters of Intent

By Joseph V. Cuomo

Prior to stepping up to the altar to say "I do," a couple generally has experienced at least some time dating – "testing the waters" as it were, – to determine if they are truly compatible. The advantages of dating prior to marriage are quite obvious. Not completely dissimilar, parties contemplating a business transaction will often find it beneficial to "date" prior to entering into a binding agreement and consummating the transaction. To facilitate this "business courtship," such parties will often enter into a Letter of Intent (or LOI).

Purposes of Letters of Intent

The main purpose of a LOI is to confirm that the parties see "eye to eye" on the basic business terms of the deal prior to proceeding with comprehensive due diligence and the preparation and negotiation of definitive documents. Before spending significant time and resources examining and documenting the detail and minutia of a transaction, it is important to know, at least on a macro level, that there are no "deal breakers." In addition, LOIs describe the ground rules for taking the process to the next level and begin to add some flesh to the bones of a transaction. Also, it is not uncommon to identify any major foreseeable obstacles (such as third-party consents and/or regulatory approvals) in the LOI so that the parties can start to discuss how best to address these items at an early stage.

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Common Elements of Letters of Intent

Business Terms of Transaction

LOIs typically lay out the principal terms of the transaction, identify the basic deal structure, and identify potential "deal breakers." LOIs reduce to paper form what the parties have discussed and agreed to with a handshake. The goal is to memorialize the main business terms of the transaction to ensure that a "deal" really does exist, and to ensure that it makes sense for the parties to invest the time and resources necessary to complete due diligence and prepare and negotiate the binding documents. In an acquisition transaction, the LOI almost always covers the deal structure (e.g., asset or stock sale), the purchase price (or range), and the payment terms. In a joint venture, LOIs usually covers the parties' respective contributions, rights and obligations with respect to the proposed new business relationship.

If the parties cannot agree on the big-picture business terms at the LOI stage, or the fundamental financial terms of the transaction, it may not be worthwhile to continue the negotiations any further. The way in which a party negotiates the LOI is often a predictor of how the agreement negotiations (and even the later ongoing business relationship under the agreement) will go. It is important to note that in most LOIs the business terms are non-binding on the parties and may, for various reasons, need to be negotiated further and sometimes even changed significantly as the transaction process proceeds. Despite this, however, it is a best practice for the parties to try in good faith to get the business terms in the LOI generally "right."

It is often a balance to get the right level of detail in an LOI. On the one hand, it is important to summarize the big-picture business deal. On the other hand, the LOI is not the final binding agreement (which will come next) and there is danger in the parties treating it as such. If the parties get too bogged down in detail at the LOI stage, the momentum of the deal may be significantly hurt or lost.

Due Diligence

It is common for the parties to set forth in the LOI both the time period and process for conducting due diligence. Due diligence is the business courtship version of "meeting the in-laws." The final deal price and certain other important business terms are only roughly estimated at the LOI stage because the LOI usually proceeds formal due diligence. During due diligence in an acquisition transaction, for example, the buyer examines in detail the legal, financial and other critical books and records of the seller, interviews employees and customers, and tests the validity of the purchase price set forth in the LOI. The LOI may identify the point person for each party for due diligence and usually lays out the time period and any deadlines. By establishing the chronology of events and parameters for due diligence in the LOI, the parties can better ride herd on what often is one of the

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most time-consuming and costly aspects of doing a transaction.

No-Shop/Exclusivity Period

One of the few terms in a LOI that is typically binding on the parties, a "no shop" or exclusivity provision protects the parties by requiring that, in the case of an acquisition transaction, the seller will not solicit or engage in any negotiations with other potential buyers for a set period of time. The time period often runs concurrently with the due diligence period. The no shop period gives the LOI party buyer comfort that it can conduct due diligence and prepare the definitive documents (and incur the costs associated therewith) without having to worry that the seller is still playing the field or, worse yet, using the buyer's signed LOI to get better offers or create a bidding war.

Non-Solicitation of Employees

A "non-solicition of employees" provision is a somewhat corresponding term to the no-shop/exclusivity provision, this time protecting the seller, not the buyer, in an acquisition deal. As part of the very nature of due diligence, a buyer will interact with the seller's officers and key employees. As such, a LOI will often include a binding non-solicitation provision that, in the event the transaction is not consummated, prohibits the buyer from soliciting and hiring the seller's employees for a certain period of time — usually one or two years. This provision is also referred to as an "anti-poaching" clause.

Confidentiality

Breaches of confidentiality can be damaging to both parties, and almost all LOIs contain a binding mutual confidentiality provision under which each party agrees to hold in confidence the other party's proprietary information and to only use such information for purposes of evaluating the potential transaction. Exceptions to these obligations are often carved out for information that is available to the public, information that is developed independently and information that must be disclosed under a court order or other similar legal process.

Binding vs. Non-binding Letters of Intent

Clients often ask if the LOI should be binding. The excitement of entering into a deal and the desire to see it close quickly once the parties shake hands sometimes drive the parties to consider entering into a binding LOI. However, a fully binding LOI is almost always a mistake for many reasons. For one, a binding LOI fails in its essential purpose – to quickly and succinctly set forth the basic deal terms to allow the parties to conduct due diligence and prepare definitive documents. If the parties truly want, or need, a binding LOI, it is a much better practice to simply proceed to the full-blown main agreement. A binding LOI that does not progress to a final signed agreement usually ends in a mess with the parties uncertain as to whether a deal exists or, in extreme cases, the parties suing each other in litigation. With that said, however, non-binding LOIs often have a number of binding provisions, including the ones discussed above – no-shop/exclusivity, non-solicitation of employees, and confidentiality. The typical contract "boilerplate" clauses are often binding too, including choice of law, a requirement that amendments to the LOI be in a signed writing with the agreement that each side is responsible for its own expenses.

Business courtship, much like romantic relationships, comes with certain risks. Business heartbreak, however, can be at least mitigated through the use of LOIs — which allow the parties to carefully examine what the marriage will look like while offering certain interim protections should things not ultimately work out.

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