Ten Mistakes to Avoid in Letters of Intent

A signed letter of intent (LOI) is considered standard practice for any material acquisition or divestiture transaction. An LOI, or an indication of interest, serves a number of critical functions: (1) the parties can determine if there is sufficient agreement on key points to support a decision to invest further resources in a transaction; (2) major issues can be resolved to avoid surprises and streamline negotiation and documentation of the deal; and (3) an agreement to negotiate on an exclusive basis provides a meaningful commitment by the seller. The LOI is also a critical first step in the give and take process of completing a deal. However, the legal landscape is littered with deals gone awry, and many of these cautionary tales trace back to a critical mistake made in the LOI.

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Mistake No. 1: Inadvertently Committing to a Deal

Any business will tell you that an LOI is just that—a letter of *intent*, not a binding commitment or agreement. Enterprising plaintiffs' lawyers will beg to differ. Absent careful language, a court can interpret an LOI out of context, extract one or two sentences in isolation, and conclude that rather than an agreement to proceed with negotiations, the LOI constitutes an agreement to buy or sell a business.

Mistake No. 2: Missing Nuances of Exclusivity

A buyer is at an inherent disadvantage if the seller has the ability to continue to seek other buyers for their business. However, there is no one size fits all exclusivity covenant. Parties that do not carefully consider their obligations and protections related to exclusivity do so at their own peril.

Mistake No. 3: Not Knowing What You're Agreeing To

Courts will read an implied covenant of "good faith and fair dealing" into every contract. An LOI that contains cursory language that is not binding could also contain provisions that are contradictory, giving rise to a claim for breach. A seller that does not agree to exclusivity could still be accused of acting in bad faith for soliciting—or even entertaining—other offers if the seller has an LOI that specifies price and other key terms.

Mistake No. 4: Not Realizing You Can Breach a "Nonbinding" Agreement

Depending on the language contained in the LOI, a buyer that believes it has no obligation to proceed with a transaction may have an obligation to use "best efforts" to complete the transaction and "negotiate in good faith" for a period of time. A buyer carelessly telling a seller it is walking away from a deal could expose the buyer to damages. Likewise, a failure to comply with a commitment in an LOI to deliver a draft purchase agreement within a specified period of time, even if designated as nonbinding, can become one party's obligation if the other party can show it relied on the statement to its detriment.

Mistake No. 5: Not Paying Attention to Subsequent Actions

Even if an LOI is well thought out and carefully worded, subsequent verbal statements can provide a basis for a plaintiff to argue that the LOI's original terms were superseded. Statements like "Don't worry about the terms in the LOI" or "I'm glad we have a deal" can be used to argue that, subsequent to the LOI's execution, the parties reached another agreement that trumped the LOI. Parties need to frequently remind themselves—and each other—that they do not yet have a deal.

Mistake No. 6: Forgetting that What You Call an LOI Doesn't Matter

Calling an LOI a "memorandum of understanding," "indication of interest" or "expression of interest" will not alter or overcome the LOI's plain language of the document.

Mistake No. 7: E-mails Can Kill

Carelessly worded e mails and text messages can be read so as to modify, amend or provide context to an LOI. Carefully manage all communications through one point of contact.

Mistake No. 8: Failing to Use Precise Language

Most typically, an LOI will delineate terms the parties consider to be nonbinding (*e.g.,* a price that is subject to the completion of a due diligence review) and binding (*e.g.,* an exclusivity obligation). The binding and nonbinding terms should be in separate sections of the LOI, under separate headings.

Mistake No. 9: Signing an LOI Without Willingness to Pursue a Transaction

Given the covenant of good faith read into all contracts, only parties that seriously intend to engage in negotiation should enter into an LOI.

Mistake No. 10: Forgetting Confidentiality

Any LOI discussing a material transaction should include at least minimal confidentiality protections, but a separately signed nondisclosure agreement is far safer.