



Letter of Intent

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"Should we prepare a letter of intent or go right to the definitive agreement?" That question usually follows the handshake between parties to a deal. The answer is that a letter of intent (LOI) is costly, often inefficient, but like other legal protocols, serves a useful purpose.

A well-drafted LOI, while generally non-binding, spells out the salient business terms forming the framework of the agreement. If properly drafted, it helps the parties avoid material misunderstandings. However, nervous parties can obsess over letters of intent and in such cases the transaction suffers from premature gridlock.

If the deal is complicated, it is important to set out some of the complicated terms in the LOI so that thousands of dollars in legal fees aren't wasted only to learn too late that the parties are unable to make the deal work. Experienced parties typically know what level of detail the LOI should and should not contain. If parties to a proposed LOI are fighting about language rather than concepts, this may be a sign that the transaction should have progressed to the formal agreement stage. On the other hand, where the language will dramatically change the concept, it is better to root out the issues at the LOI stage.

Sometimes, parties are so thorough (and their legal budget tapped out) in their preparation of a LOI that they think they can use it as their transaction document without further agreements ever being drafted. This shortcut generally leads to disaster. If the transaction later leads to litigation, the typical LOI won't be very helpful to at least one of the litigants.

The LOI serves another purpose. Language stating that the LOI is not a binding agreement often contains exceptions for certain critical covenants by the parties. For example, a party selling a business will often agree in the LOI not to offer his company for sale to any other prospective buyer for a given period of time. The party proposing to purchase the business will agree to keep the information she learns during the investigative stage of the transaction strictly confidential. Thus, while the LOI is purportedly non-

binding, if properly drafted these covenants will exist independently and survive the expiration of the LOI for a specified period of time.

The LOI, like so much else in a transactional legal practice, is preventative medicine designed to avoid later problems. Convincing our clients to take them seriously is not always easy, but the prudent practitioner makes sure to use the LOI as an indispensable tool of the trade.

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