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# Hidden Dangers in Letters of Intent

## *Can an LOI jeopardize my deal?*

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Dealmakers commonly use letters of intent, term sheets or memorandums of understanding (better known as "LOIs") early in a potential transaction to outline the general business terms of a proposed deal. LOIs can save time and money by enabling the parties to agree on important business issues before drafting the detailed transaction documentation. Because the details of the deal have not been hammered out at this stage, the parties involved probably do not intend for the LOI to be binding (other than perhaps certain limited provisions of the LOI, such as confidentiality and exclusivity).

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If you are entering into a deal, you should be aware that you cannot always walk away from negotiations with a seemingly nonbinding LOI.

LOIs are generally intended to serve as the framework for negotiating a legally binding transaction. Before investing substantial time and money into due diligence with lawyers and accountants, parties like to ensure they have a "meeting of the minds" on basic deal terms. A non-binding LOI also enables principals to reach general agreement on terms by simple reference to complex business concepts, which can later be expanded and refined with the assistance of counsel in the final deal documents. For example, parties to an LOI for the sale of a business might state that the purchase price is $1 million, but then spell out the timing of payments and any contingencies in the final purchase agreement.

Despite the intent for an LOI to be nonbinding, a line of cases suggests that even seemingly nonbinding LOIs entail a number of risks.

In a 2002 case, *Copeland v. Baskin Robbins U.S.A., et al.*, a California court ruled that a document intended to set out the general terms of a transaction may serve as the basis for a binding obligation to negotiate the actual deal in good faith. The court explained that a "contract to negotiate" is distinguishable from an unenforceable "agreement to agree" because unlike the case with an "agreement to agree," the parties to a "contract to negotiate" can fulfill their obligations even if a definitive agreement is never reached. A Delaware court issued a similar ruling in 2009 in *Global Asset Capital, LLC v. Rubicon US Reit, Inc.* In this case, the court stated that if parties intend for an LOI to be non-binding, they "can readily do that by expressly saying that the letter of intent is non binding." The court explained, "parties enter into letters of intent for a reason. They don't enter into them…[to] be disregarded whenever situations change. They enter into them because they create rights." Another Delaware court's decision (*PharmAthene, Inc. v. SIGA Technologies, Inc.*) earlier this year added a further layer of complexity to the body of LOI case law. In *SIGA*, the court awarded damages where, despite a term sheet that clearly stated it was non-binding, the court found that the plaintiff had acted reasonably in relying on the term sheet and the defendant's conduct when the plaintiff provided financial and operational support to the defendant.

As these cases show, parties to an LOI may unwittingly create an enforceable obligation to negotiate in good faith absent obvious language in the LOI to the contrary. For this reason, if you do not want to create binding obligations in an LOI, you could include an express statement in your LOI to that effect. You may also want to state in your LOI that either party may terminate discussions at any time for any reason, and that the parties are not obligated to negotiate a definitive agreement. If you do intend for certain provisions of the LOI to be binding, you should consider drafting those provisions in a separate section of the LOI and specify, both in the introductory paragraph and at the end of the LOI, that other than those specific provisions, the LOI is not intended to create any legally binding obligations.

If you want to commit to negotiate a definitive transaction in good faith, you should specify concrete actions that each party must take to satisfy that standard, so the parties can determine when they are free to walk away from the deal. Moreover, as the *SIGA* case demonstrates, you need to be very cautious in your dealings with your counterparty, as either party's conduct in reliance on a nonbinding LOI may itself serve as the basis for liability.

While LOIs are a tool of convenience and can be very simple on the surface, if you are not careful in drafting your LOI or you are not cautious in your interaction with the other side, you might easily find yourself tied up in costly and distracting litigation or a deal you did not really want.

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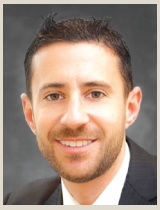

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