

BUYING OR SELLING A BUSINESS

THE LETTER OF INTENT

By **Gianfranco A. Pietrafesa**

A letter of intent (also known as a term sheet and memorandum of understanding) sets forth the basic terms of a deal. A letter of intent is usually the second document (after a non-disclosure agreement) signed by the parties when buying or selling a business.

There are a number of reasons to use a letter of intent. First, it allows the parties to summarize the key terms and conditions of the transaction, which reduces or even eliminates future misunderstandings during negotiations of the transaction documents. A letter of intent also identifies problems (or deal-breakers) in the early stages of the negotiations, before incurring the costs of negotiating and preparing the transaction documents and performing due diligence on the seller.

Second, the letter of intent can govern the parties' relationship during the time between the date of the letter of intent and the date the transaction documents are signed. This time period can be significant depending on, for example, the nature and scope of the buyer's due diligence on the seller.

Third, a buyer can use a letter of intent to obtain financing from a lender.

Contents

A letter of intent should include most, if not all, of the following provisions.

1. **Deal Structure.** A description of the transaction; for example, whether it will be a stock purchase or an asset purchase.

2. **Exclusions.** A description of any assets or liabilities that will be excluded from the transaction.

3. **Price.** The proposed purchase price or the method for determining the purchase price, and any adjustments to the same.

4. **Payment Terms.** The payment terms, such as whether the purchase price will be paid in cash, promissory notes and/or securities, and the collateral securing payment of any promissory notes.

5. **Indemnification/Escrow.** A description of any indemnification obligations of the seller and any amount of the purchase price to be held in escrow to satisfy the indemnification obligations.

6. **Employment/Consulting.** Identification of any employment agreements for the seller's employees and/or consulting and/or non-competition agreements for the selling owners of the business.

7. **Conditions.** Any conditions that must occur before closing; for example, financing to be obtained by the buyer, satisfactory due diligence by the buyer, consents to be obtained from third parties (such as landlords), and any necessary approvals to be obtained from regulatory agencies.

8. **Due Diligence.** The scope, time period and procedures for the buyer's due diligence of the seller's business.

9. **Confidentiality.** If the parties entered into a non-disclosure agreement, it should be referred to in the letter of intent. If not, the letter of intent should address the buyer's obligation to maintain the confidentiality of the confidential information provided by the seller.

10. **Non-Solicitation.** A buyer's prohibition against soliciting the seller's employees for a certain period of time if the deal does not close.

11. **Representations and Warranties.** A description of any specific representations and warranties that will be required in the contract documents.

12. **Ordinary Course.** The obligation of the seller to conduct its business in the ordinary course consistent with past practice and to avoid any extraordinary transactions without the buyer's prior consent.

13. **Exclusivity.** A buyer may want a provision requiring the seller to deal exclusively with the buyer and not to seek or entertain other offers.

14. **Miscellaneous.** Customary provisions such as governing law and jurisdiction of disputes.

Binding vs. Non-Binding

Typically, the deal terms in a letter of intent, such as the purchase price and payments terms, are non-binding. That is, the parties do not intend to be legally bound to these terms until they sign the transaction documents. However, other terms in the letter of intent are intended to be binding. For example, the obligation to maintain the confidentiality of the seller's confidential information and prohibiting the buyer from soliciting the seller's employees.

To minimize, and ideally prevent, disputes about whether a letter of intent is binding or non-binding, a letter of intent is frequently divided into two distinct sections, one containing the binding provisions and the other the non-binding provisions.

Conclusion

Buyers and sellers should have their attorneys prepare or review letters of intent for three reasons: To ensure that (1) they contain necessary terms, (2) they accurately summarize the terms of the deal, and (3) certain terms are binding and others non-binding.

For more information on letters of intent and term sheets, or on buying or selling a business, please contact Franco at pietrafesa@archerlaw.com or 201-498-8559.



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