Effective Use of Letters of Intent

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A Letter of Intent ("LOI") is quite often the first document between business people to record their understanding of the main commercial terms for a potential transaction. One of the benefits of an LOI is that it minimizes the chances of a transaction not proceeding because of a failure or misunderstanding to have a meeting of the minds on some of the basic commercial terms. This avoids wasting time, wasting resources and the costs associated with both before the parties get too far along.

Very often, a LOI is established with the expectation that the terms, or at least some of them, will be "non-binding". However, caution should be had when entering into any type of LOI and make it explicit which terms are and are not binding and proceed in the manner that does not give rise to the impression that both parties believe an agreement to have been consummated. A few years ago, the Ontario Court of Appeal found that parties to a prospective transaction were bound by the terms of their initial document despite not having signed a formal commercial agreement (in this case a share purchase agreement). The Court found that the language in the "LOI" contained terms that suggested a meeting of the minds and the conduct of the parties to signing the "LOI" was sufficient to conclude that the parties had an intention to be bound by an agreement they had not yet signed.

As a result, in preparing a LOI, it is very important to ensure that the "non-binding" and the "binding" provisions are clearly specified. While items such as the structure, price, and necessity to enter into more definitive agreements are typically ones which you would expect

would be “non-binding”, one can expect that such matters such as confidentiality, exclusivity during the period of inspection, access to due diligence materials will be requested to be “binding”. In addition, caution should be had to the use of terms which suggest an agreement which is not intended (for example, terms like “agreed”, “agreement”, and “upon acceptance”)

It’s important to also manage the conduct of how certain parties behave throughout the process once a LOI is signed and in the course of negotiating more definitive agreements. For example, in connection with a purchase of a business, what type of disclosure has there been made to learn and operate the business? Has there been any communication with the employees of the business and if so, what message has been sent.

A LOI is a valuable document when business owners are in the “honeymoon phase” at the outset of their relationship to establish as many of the key terms as possible in connection with the prospective transaction. It sets the tone of negotiation for the future and the process to be undertaken in an orderly manner; but caution should be had to ensure the provisions of the LOI are specific as to what is binding and what is not binding and the conduct of the parties subsequent to the signing of the LOI is managed to avoid any argument that the parties had an intention to be bound despite not signing formal or definitive agreement

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