

# Model Stock Purchase Agreement, Second Edition

## ANCILLARY DOCUMENT B

# Letter of Intent

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### PRELIMINARY NOTE

A letter of intent is often entered into between a buyer and a seller following the successful completion of the first phase of negotiations of an acquisition transaction. The letter generally, but not always, describes the purchase price (or a formula for determining the purchase price) and certain other key economic and procedural terms that form the basis for further negotiations. In most cases, the buyer and the seller do not yet intend to be legally bound to consummate the transaction and expect that the letter of intent will be superseded by a definitive written acquisition agreement. Alternatively, buyers and sellers may prefer a memorandum of understanding or a term sheet to reflect deal terms.

Although the seller and the buyer will generally desire the substantive deal terms outlined in a letter of intent to be nonbinding expressions of their then current understanding of the shape of the prospective transaction, letters of intent frequently contain some provisions that the parties intend to be binding. As discussed more fully below, the binding provisions of a letter of intent generally relate to the process of conducting the negotiations and proceeding towards a definitive agreement.

A client should have the benefit of its lawyer's advice before entering into a letter of intent. What portions of the letter of intent should be binding or nonbinding and the risks of entering into a letter of intent at all are important issues with a heavy legal overlay. The level of detail in the letter of intent and which issues should be addressed or deferred are key strategic questions that should be discussed with the client, and their likely impact on the negotiation of the acquisition should be fully explored.

There are several reasons why letters of intent are used. A buyer and a seller frequently prefer a letter of intent to test the waters before incurring the costs of negotiating a definitive agreement and performing due diligence. The parties may also feel morally, if not legally, obligated to key terms once they are set down in writing. Sometimes the deal terms are sufficiently complicated that it is helpful to put them down in writing to ensure that the buyer and seller have consistent expectations.

Signing a letter of intent at an earlier stage of the acquisition process, rather than waiting for the definitive agreement, can facilitate compliance with regulatory requirements. For example, a premerger notification form can be filed under the HSR Act upon entering into a letter of intent, thereby starting the clock on the applicable waiting period. See the discussion of the HSR Act in Section 1.1 of the Model Agreement. A signed letter of intent may also assist the buyer in convincing prospective lenders or investors to evaluate the transaction for the purpose of providing financing. The letter of

intent often provides an outline for the transaction that can be used as the basis for drafting the definitive agreement.

Letters of intent are also used to define the rights and obligations of the parties while a definitive agreement is being negotiated. For example, an exclusivity provision is often included, which prohibits the seller from negotiating with another party while negotiations with the buyer are ongoing. A letter of intent, either alone or in conjunction with a separate confidentiality agreement, will usually permit the buyer to inspect the target's properties and to review its operations and books and records while simultaneously restricting the buyer's ability to disclose and use the target's trade secrets and other proprietary information received during the negotiations. A letter of intent often covers how expenses of the acquisition and negotiations, such as fees and expenses of brokers, attorneys, and other advisors, will be paid and limits the rights of each party to publicize the acquisition or negotiations without the consent of the other party. A letter of intent may establish the time frame for conducting due diligence and closing the acquisition and certain other milestones and pre-conditions prior to the execution of a definitive agreement or the closing of the transaction.

Many commentators and business lawyers believe that the effect of a letter of intent is generally more favorable to the buyer than to the seller. An exclusivity provision in the letter of intent may prevent the seller from introducing other interested parties to the acquisition to enhance its negotiating position with the buyer. In those cases where a letter of intent is not used, the buyer might consider entering into a separate exclusivity agreement with the seller. If actual or suspected problems are uncovered during due diligence, the buyer may try to use that information to negotiate a lower purchase price or more favorable terms. A signed letter of intent, even if not binding, together with the buyer's inspection of the target's properties and review of its operations and books and records, often will create an expectation on the part of the target's employees, vendors, customers, lenders, or investors that a sale to the buyer will occur. Buyer's investigation of the target may also uncover information that can be used by the buyer to compete with the target if the sale is not consummated, even if the target receives protection against the disclosure or use by the buyer of the target's trade secrets and other proprietary information.

Notwithstanding these considerations, a seller is often as insistent as a buyer that a letter of intent be executed before work on a definitive agreement is begun. One reason may be that the negotiation of a letter of intent provides the seller with an excellent opportunity to negotiate certain key acquisition issues at a time when the seller possesses maximum leverage. The seller may also feel pressure to show some evidence of a prospective transaction to lenders or other interested persons. If the seller is not bound by an exclusivity provision, it may want to use the letter of intent to prompt other potential buyers to compete for the business transaction opportunity.

A controlled auction process (see M&A PROCESS ch. 6) may or may not include a letter of intent, depending on how the process is conducted, the completeness of documentation, and other timing issues.

Although letters of intent are common, no consensus exists among business lawyers regarding their desirability. Many lawyers advise their clients that the great disadvantage of a letter of intent is that provisions intended by the parties to be nonbinding may be later found by a court to be binding. There is often an inherent conflict between the goals of the parties in negotiating a letter of intent. The buyer generally is most interested in securing exclusivity or other standstill types of provisions

from the seller while seeking to maintain great flexibility regarding the purchase price and other key provisions that may be impacted by the results of the buyer's acquisition review of the target. The seller, on the other hand, generally will attempt to define more clearly the purchase price, limitations on its exposure with respect to the representations that will be part of the definitive agreement, and key terms of employment agreements, noncompete covenants, and other ancillary arrangements. If possible, the seller will prefer to avoid altogether, or to limit the scope of, any exclusivity commitment. The negotiation of a letter of intent can sometimes become bogged down in detailed discussions that are generally reserved to the negotiation of the definitive agreement. Because of these twin concerns of the possible, but unintended, binding nature of the letter of intent and the risk that the negotiation of the letter of intent will become mired in endless detail, lawyers often advise their clients to forgo a letter of intent and commence negotiation of a definitive agreement.

It is helpful at the outset to determine the client's desires as to whether a letter of intent is binding. For example, the acquisition may be so economically or strategically attractive that the client is willing, as a business decision, to risk being bound at this initial stage. The parties might also intend to be bound if the acquisition review has been completed and all economic issues have been settled. However, a fully binding letter of intent can lead to problems and unexpected results if the parties later are unable to agree to the terms of a definitive agreement. In that event, a court may impose upon the parties its interpretation of commercially reasonable terms for any unresolved issues.

At the stage in the transaction when the letter of intent is signed, the transaction itself usually is still conditional in nature. Most often, many terms have not even been considered, much less discussed or settled. Moreover, due diligence is rarely completed at this stage and quite often not even commenced, and both parties may be oblivious to many potential pitfalls. Accordingly, the buyer may want to avoid specifics on many business deal points. This strategy may enhance the buyer's negotiating position by deferring discussions on these key issues until after the buyer has completed its due diligence and the seller's negotiating position has been compromised by executing a letter of intent. The seller, on the other hand, will want in most cases to resolve all important issues at the letter of intent stage when the seller may have its greatest negotiating leverage. For example, the seller may want to negotiate limitations with respect to its indemnification obligations in the letter of intent by providing for a cap, a basket, an expiration of the indemnification obligations, reliance on the indemnity provisions as the buyer's exclusive remedy, or some combination of these concepts. The seller may also seek to avoid guaranties and draconian escrows at the outset by facing these issues at the letter of intent stage.

## **Legal Principles**

The legal principles for determining whether a letter of intent is binding are fairly easy to state, although often difficult to apply:

- If the parties intend not to be bound to each other prior to the execution of a definitive agreement, the courts will give effect to that intent, and the parties will not be bound until the agreement has been executed. This is true even if all issues in the negotiations have been resolved. See *R. G. Group, Inc. v. Horn & Hardart Co.*, 751 F.2d 69 (2d Cir. 1984); *V'Soske v. Barwick*, 404 F.2d 495 (2d Cir. 1968).

- On the other hand, if the parties intend to be bound prior to the execution of a definitive agreement, the courts will also give effect to that intent and the parties will be bound even though they contemplate replacing their earlier understanding with a definitive agreement at a later date. See *Texaco, Inc. v. Pennzoil Co.*, 729 S.W.2d 768 (Tex. App. 1987), *cert. denied*, 485 U.S. 994 (1988); *but see Durbin v. Dal-Briar Corp.*, 871 S.W.2d 263 (Tex. App. 1991); *cf. Isern v. Ninth Court of Appeals*, 925 S.W.2d 604 (Tex. 1996) (superseded by statute), *cert. denied*, *Watson v. Isern*, 117 S. Ct. 612 (1996); *R. G. Group*, 751 F.2d at 74; *V'Soske v. Barwick*, 404 F.2d 495 (2d Cir. 1968).
- Parties intending to be bound prior to the execution of a definitive agreement will be bound even if there are certain issues that have not been resolved. Depending upon the importance of the open items, the courts will either supply commercially reasonable terms for those unresolved issues or impose a contractual duty on the parties to negotiate the resolution of those issues in good faith. See *Itek Corp. v. Chicago Aerial Indus., Inc.*, 248 A.2d 625 (Del. 1968). When the courts impose a duty to negotiate open terms in good faith, they will impose liability if one party acts in bad faith. See *Fickes v. Sun Expert, Inc.*, 762 F. Supp. 998 (D. Mass. 1991). On the other hand, if the parties do negotiate in good faith, the fact that a final agreement is not reached will not result in liability. See *Feldman v. Allegheny Int'l, Inc.*, 850 F.2d 1217 (7th Cir. 1988). See *also Copeland v. Baskin Robbins U.S.A.*, 117 Cal. Rptr. 2d 875 (Cal. App. 2002) (contract may constitute agreement to negotiate in good faith).

In determining whether the parties intend to be bound, the courts generally examine the following factors:

- the actual words of the document;
- the context of the negotiations;
- whether either or both parties have partially performed their obligations;
- whether there are any issues left to negotiate; and
- whether the subject matter of the discussions concerns complex business matters that customarily involve definitive written agreements.

See *Teachers Ins. and Annuity Ass'n v. Tribune Co.*, 670 F. Supp. 491 (S.D.N.Y. 1987); *Arcadian Phosphates, Inc. v. Arcadian Corp.*, 884 F. 2d 69 (2d Cir. 1989); *Texaco*, 729 S.W.2d at 768; *R. G. Group, Inc. v. Horn & Hardart Co.*, 751 F.2d 69 (2d Cir. 1984).

Courts have consistently stated that the most important factor in determining whether or which provisions in a letter of intent are binding is the language used by the parties in the document. The language of the letter of intent should, therefore, be definite and precise. A lawyer might advise the client, however, to avoid factual situations and subsequent communications that have led some courts to find provisions of a letter of intent to be binding despite language seemingly to the contrary in the document. There are many things that can overcome the carefully crafted words in a letter of intent purporting to make a document or certain provisions in a document nonbinding. Loosely

worded e-mails, oral communications, and other actions are often given great weight by courts in interpreting the intent of the parties. Oral statements such as “Looks like we have a deal!” or handshakes can indicate an intent to be bound. See *American Cyanamid Co. v. Elizabeth Arden Sales Corp.*, 331 F. Supp. 597 (S.D.N.Y. 1971); *Computer Sys. of Am., Inc. v. IBM Corp.*, 795 F.2d 1086 (1st Cir. 1986). *But see* *Reprosystem, B. V. v. SCM Corp.*, 727 F.2d 257 (2d Cir. 1984), *cert. denied*, 469 U.S. 828 (1984); *R. G. Group*, 751 F.2d 75–76 (2d Cir. 1984); *Seaman’s Direct Buying Serv., Inc. v. Standard Oil Co.*, 686 P.2d 1158 (Cal. 1984).

When parties to a letter of intent have clearly identified that certain provisions are binding (such as exclusivity) and others are not, courts will enforce the binding provisions as bargained-for agreements and not lightly read in unstated exceptions such as fiduciary outs. See *Global Asset Capital, LLC vs. Rubicon US Reit, Inc.*, C.A. No. 5071-VCL (Del. Ch. Nov. 16, 2009).

### **Sample Letters of Intent**

Two illustrative letters of intent are provided below. The first (“Long Form”) is a much more comprehensive and legally precise form, designed to flush out many of the pertinent issues and to make very clear which elements of the letter are binding and which are not. The second illustrative letter of intent (“Short Form”) is a much shorter, less formal, and less legalistic form that might be used when one or both of the parties are very anxious to sign a letter of intent on short notice at an early stage of discussion, while preserving protections against later litigation if negotiations break off.

Both illustrative letters of intent contemplate the proposed acquisition by a single corporate buyer of all the outstanding capital stock of a privately held company from its shareholders. The purchase price would be payable with a combination of cash and notes, and a portion of the cash payment due at closing would be escrowed. This fact pattern is consistent with the Fact Pattern for the Model Agreement.

Both illustrative letters of intent have been prepared as a buyer’s first draft, recognizing the custom that the buyer or its counsel will generally prepare the first draft of a letter of intent.

Letters of intent such as the Short Form that are less formal and comprehensive can also be effective, and many clients prefer a less comprehensive approach. The primary advantages of a comprehensive, longer letter of intent, such as the Long Form, are: (a) issues that are deal-breakers can be identified early in the negotiation process before substantial expenses are incurred in due diligence and the drafting of a definitive agreement with any accompanying disclosure letter or schedules, (b) resolution of difficult issues at the letter of intent stage facilitates the negotiation of a definitive agreement, permitting the buyer more time and energy to prepare for the transition to its ownership of the target, and (c) legal counsel for both parties are sometimes more successful in prompting their clients to focus on and understand important issues that might otherwise be lost or misunderstood in the much more complex, definitive documents. The primary disadvantage of a comprehensive letter of intent such as the Long Form is that it may burden the negotiations with too many difficult issues too early in the process and may impede the deal’s momentum or even cause a breakdown in the negotiations that may have been avoided if certain issues had been deferred. Consideration should be given to the strategic impact of a comprehensive letter of intent on the negotiating dynamics of a deal before a letter of intent based upon the Long Form is prepared.

The Long Form is divided into two parts: provisions intended not to be binding and provisions intended to be binding. The nonbinding provisions consist primarily of the business deal points, such as a description of the proposed transaction, the purchase price, and key ancillary agreements. The binding provisions focus on the regulation of the negotiation process, including access for the buyer to conduct its due diligence, exclusivity, payment of the parties' expenses, and termination provisions. The nonbinding and binding portions of the Long Form are clearly delineated to assist a court in determining the intent of the parties, if that becomes necessary. Another common format is to set out binding and nonbinding provisions without grouping them in separate parts and to include a general statement that the entire letter of intent is nonbinding, except for certain provisions that are specifically itemized by paragraph number. This is the format used in the Short Form. Care should be taken where the itemization is by reference to paragraph numbers or letters that redrafting changes do not result in inadvertent reference to the wrong paragraphs.

Given the many considerations involved in negotiating a letter of intent, it cannot be overemphasized that virtually everything in a letter of intent is subject to variation based upon the particular context of the proposed acquisition. There is no such thing as a standard letter of intent applicable to all proposed acquisitions.

With respect to letters of intent in general, see M&A PROCESS ch. 8; Kling & Nugent Ch. 6; Spreen, *Ten Practice Tips for Negotiating the Letter of Intent*, DEAL LAW. 13 (May-June 2008).

## LONG FORM LETTER OF INTENT

[Date]

Seller [1]

Seller [2]

...

Seller [8]

**Ladies and Gentlemen:**

**This letter will confirm that \_\_\_\_\_ (“Buyer”) is interested in acquiring all the outstanding capital stock (the “Shares”) of \_\_\_\_\_ (the “Company”) from you (“Sellers”), all the Company’s shareholders. In this letter, (a) the Company and its subsidiaries are called the “Acquired Companies,” and (b) Buyer’s possible acquisition of Shares (or other acquisition of the Company) is sometimes called the “Possible Acquisition.”**

### **PART ONE—NONBINDING PROVISIONS**

**The parties wish to commence negotiating a definitive written acquisition agreement providing for the Possible Acquisition (a “Definitive Agreement”). To facilitate the negotiation of a Definitive Agreement, the parties request that Buyer’s counsel prepare an initial draft. The execution of any Definitive Agreement would be subject to the satisfactory completion of Buyer’s**

**ongoing investigation of the Acquired Companies' business and would also be subject to approval by Buyer's board of directors.**

**Based upon the information currently known to Buyer, it is proposed that the Definitive Agreement would include the following terms:**

#### **COMMENT**

The introductory paragraphs of Part One make explicit the customary practice that the buyer and its counsel prepare the initial draft of the definitive agreement. This allows the buyer to control the drafting process and the timing of negotiations. Sellers may counter, requesting that the Letter of Intent contain specific dates by which drafts will be prepared, comments received, new drafts prepared, and similar deadlines.

The introductory paragraphs put Sellers on notice that the form of any definitive agreement must be approved by Buyer's board of directors. In addition, this provision may provide Buyer with some protection if the nonbinding provisions are determined to be binding and enforceable. See *A/S Apothekernes Laboratorium v. LM.C. Chemical Group, Inc.*, 873 F.2d 155 (7th Cir. 1989). Sellers may object to this provision and instead insist that the Letter of Intent contain a specific confirmation that Buyer's board has approved the Letter of Intent.

The initial phrase of the last paragraph of this introductory section ("Based on the information currently known to Buyer. . .") is intended to provide Buyer with a defensible moral and legal (if the provisions of Part One are construed to be binding) position that its due diligence of the target may result in Buyer offering a lower purchase price or different terms than those contained in the Letter of Intent.

#### **1. BASIC TRANSACTION**

**Sellers would sell all the Shares to Buyer at the price (the "Purchase Price") set forth in Paragraph 2 at the closing of the Possible Transaction (the "Closing"), which is expected to be no later than \_\_\_\_\_.**

#### **COMMENT**

Paragraph 1 and each of the other paragraphs of Part One state the business deal points of the proposed acquisition. As mentioned in the Preliminary Note, these deal points correspond to the assumptions underlying the Model Agreement, which contains commentary that may also be applicable to Part One.

In Paragraph 1 and throughout Part One, the word "would" is used. This word is intended to convey the conditional nature of the proposed acquisition and to contrast with the more definite words used in the binding provisions of Part Two, such as "will." Other conditional terms may also be used, such as "prospective buyer," "prospective seller," and "proposed transaction." While the conditional language of Part One may appear awkward and stilted at times, it provides another indication of the parties' intent that the provisions of Part One are not be binding.

#### **2. PURCHASE PRICE**

**The Purchase Price would be \$\_\_\_\_\_ (subject to adjustment as described below) and would be paid in the following manner:**

- (a) at the Closing, Buyer would pay Sellers \$\_\_\_\_\_ in cash;
- (b) at the Closing, Buyer would deposit with a mutually acceptable escrow holder \$\_\_\_\_\_, which would be held in escrow for a period of at least \_\_\_\_\_ years in order to secure the performance of Sellers' obligations under the Definitive Agreement; and
- (c) at the Closing, Buyer would execute and deliver to each Seller an unsecured nonnegotiable promissory note. The promissory notes to be delivered to Sellers by Buyer would have an aggregate principal amount of \$\_\_\_\_\_, bear interest at the rate of \_\_\_\_\_ % per annum, mature on the \_\_\_\_\_ anniversary of the Closing, and provide for \_\_\_\_\_ equal [annual] [quarterly] payments of principal along with [annual] [quarterly] payments of accrued interest.

The Purchase Price assumes that the Acquired Companies have consolidated shareholders' equity of at least \$\_\_\_\_\_ as of the Closing. The Purchase Price would be adjusted based on changes in the Acquired Companies' consolidated shareholders' equity as of the Closing on a dollar-for-dollar basis.

### COMMENT

If Buyer expects to require an escrow or other holdback of a portion of the proposed purchase price, it may be important to include a specific provision to that effect. At the letter of intent stage, Buyer typically may not be able to determine or defend a specific amount to be escrowed. Buyer will be better able to do so following its due diligence. Even if the amount of the escrow or holdback is not yet determined, a statement that one will be required will put Sellers on notice and should make the subsequent negotiation of that issue easier. Obtaining Sellers' agreement to an escrow or holdback is difficult if the issue has not been raised prior to signing a letter of intent and the due diligence fails to reveal any compelling new reasons for one.

Buyer may also want to describe known areas of potential liability, such as environmental clean-up and pending litigation, that will affect the purchase price. By putting Sellers on notice at an early stage that such liabilities will affect the purchase price, escrowed amount, or other amounts held back, Buyer's position to negotiate these issues in the definitive agreement should be enhanced.

There are a variety of purchase price adjustment mechanisms that may be included in any particular transaction. For example, the purchase price adjustment may include limitations in the form of caps, collars, and floors. The parties may desire the letter of intent to include detailed provisions describing the timing, method, and process of calculating the purchase price adjustment, although such details are usually subject to heavy negotiation that might be more appropriate to the negotiation of the definitive agreement. The parties should be sensitive to the fact that post-closing purchase price adjustments can be the subject of considerable dispute and contention, especially if they are complex or include criteria that can be manipulated by one of the parties. The parties may wish to reference in general terms a specific type of dispute resolution mechanism that would be contained in the definitive agreement to address the possibility of disagreement on the purchase price adjustment. The parties may also agree to place a portion of the purchase price in a separate escrow to facilitate payment of the adjustment amount. For further discussion on purchase price adjustments, see Sections 2.5 and 2.6 of the Model Agreement and related commentary.



### 3. EMPLOYMENT AND NONCOMPETITION AGREEMENTS

At the Closing:

- (a) the Company and \_\_\_\_\_ would enter into a \_\_\_\_\_-year employment agreement pursuant to which he/she would agree to continue to serve as the Company's \_\_\_\_\_ and would be entitled to receive a salary of \$\_\_\_\_\_ per year; and
- (b) each Seller would execute a \_\_\_\_\_-year noncompetition agreement in favor of Buyer.

#### COMMENT

The noncompetition provisions may be included within the definitive acquisition agreement or, as provided in this sample letter of intent, as a separate agreement. Paragraph 3 does not contemplate separate consideration for the noncompetition covenants. The parties should consult qualified tax advisors on the tax consequences of allocating (or failing to allocate) a portion of the purchase price to noncompetition obligations. See the commentary to Sections 2.2 and 7.2 of the Model Agreement.

If more than one transaction document contains noncompetition provisions, care should be taken to ensure that they are consistent and do not cause unnecessary tax risks. See Appendix C—Considerations Regarding Employment Agreements in Connection with Sale of Stock and commentary to Section 7.2 of the Model Agreement for further discussions of these and other issues.

### 4. OTHER TERMS

**Sellers would make comprehensive representations and warranties to Buyer and would provide comprehensive covenants, indemnities, and other protections for the benefit of Buyer. The consummation of the Possible Acquisition by Buyer would be subject to the satisfaction of various conditions required to be satisfied prior to Closing, which would include, but not be limited to, the following:**

- (a) **Sellers will own 100% of the outstanding capital stock of the Company, and the Shares will be free and clear of all liens and encumbrances;**
- (b) **There will have been no material adverse change in the business or financial condition of any Acquired Company;**
- (c) **Buyer's satisfactory environmental audit of all real properties owned or occupied by each Acquired Company;**
- (d) **Between the date of the Definitive Agreement and the Closing, Sellers will cause the Acquired Companies to operate their business in the ordinary course and to refrain from any extraordinary transactions;**
- (e) **The truth and accuracy of the representations and warranties of Sellers set forth in the Definitive Agreement;**
- (f) **Sellers will have performed or complied in all material respects with all agreements required by the Definitive Agreement to be performed or complied with by them; and**
- (g) **Such other conditions as are customary in transactions of this type.**

## COMMENT

Specific representations and covenants may be added to Paragraph 4, as well as the survival period of representations, indemnification limits, and related provisions. Unless Buyer has specific concerns prior to signing the Letter of Intent, Buyer will generally prefer to defer discussions regarding these provisions to negotiation of the definitive agreement until its due diligence of the target is more advanced and Sellers' negotiating position may be weaker. The absence of specific provisions in the letter of intent, however, may encourage Sellers to request a full discussion of the representations and covenants that will be required. Moreover, Sellers may recognize that the negotiation of the letter of intent affords it an opportunity to establish limits on representations, covenants, and indemnities that may be subsequently difficult to obtain. Usually, the extent of representations and indemnities given by Sellers in a particular transaction will depend on the circumstances surrounding the transaction. For example, the sale of a distressed company may result in a lower purchase price, but be made with limited or no warranty protection or strict limitations on Sellers' liability. It may benefit the parties to use the letter of intent as an opportunity to establish a common expectation with respect to the scope of representations, covenants, and indemnities.

While many specific conditions to the acquisition may be omitted from a letter of intent and included in the definitive agreement, vital, "deal-breaking" terms and conditions are often included at this stage. If the letter of intent gives rise to an obligation to negotiate in good faith, the introduction of new terms and conditions not included may constitute bad-faith negotiations. In one extreme example, a buyer's good-faith attempt, albeit unsuccessful, to obtain financing was held to be bad-faith negotiating because the letter of intent did not make the acquisition contingent on obtaining financing. See *Bruce v. Marcheson Implementos E. Maquinos Agrícolas Tatu, S.A.*, 1990 U.S. Dist. LEXIS 18527 (S.D. Iowa 1990).

Buyer may want to list in Paragraph 4 all conditions precedent to the acquisition that will eventually appear in the definitive agreement to ensure that Sellers are fully aware at an early stage of what will be required. An alternative and more often used strategy would be to include only those conditions that differ from the standard conditions precedent that commonly appear in acquisition agreements and otherwise state that the agreement would contain conditions customarily included in agreements of this type.

Any other key terms or assumptions of the proposed acquisition should be added to Paragraph 4 or elsewhere in the nonbinding provisions of Part One.

## PART TWO—BINDING PROVISIONS

**The parties, intending to be legally bound, agree to the following legally enforceable paragraphs of this letter.**

### 5. ACCESS

**Sellers will cause the Company to afford Buyer and its duly authorized representatives full and free access to each Acquired Company, its personnel, properties, contracts, books and records, and all other documents and data, subject to the Confidentiality Agreement referred to in Paragraph 8.**

## COMMENT

Paragraph 5 specifies Sellers' binding obligation to cooperate in Buyer's due diligence investigation. Sellers must not only provide Buyer and its representatives access to each Acquired Company's properties and books and records but also access to their personnel.

Sellers may be reluctant to disclose certain information about the Acquired Companies' customers, marketing strategies, new products, and other sensitive areas until after the definitive agreement is executed or later. Sometimes staged access to such information is negotiated in the letter of intent.

Sellers may object to "full and free" access, which may mean regardless of the time of day and regardless of the disruption caused. See commentary to Section 5.1 of the Model Agreement for a discussion of reasonable access.

In the event that a significant portion of the purchase price is to be paid with promissory notes or Buyer securities, Sellers will likely request certain information from, and due diligence rights with respect to, Buyer. In most cases, Buyer may seek to limit its disclosure obligations to financial information and developments that may materially and adversely affect its business.

## 6. EXCLUSIVE DEALING

- (a) **Sellers will not, and will cause the Acquired Companies not to, directly or indirectly, through any representative or otherwise, solicit or entertain offers from, negotiate with or in any manner encourage, discuss, accept, or consider any proposal of any other person relating to the acquisition of the Shares or the Acquired Companies, their assets or business, in whole or in part, whether directly or indirectly, through purchase, merger, consolidation, or otherwise (other than sales of inventory in the ordinary course); and**
- (b) **Sellers will immediately notify Buyer regarding any contact between Sellers, any Acquired Company, or their respective representatives and any other person regarding any such offer or proposal or any related inquiry and if made in writing furnish a copy thereof.**

## COMMENT

Paragraph 6 restricts Sellers from soliciting or considering other offers to acquire the target until the letter of intent is terminated. This provision is commonly known as an exclusivity provision and is often the primary goal of Buyer in entering into a letter of intent. See Section 5.6 of the Model Agreement for a more detailed discussion of these provisions and the issues they raise. This Paragraph, which also provides that Sellers will immediately notify Buyer of any third-party overture, should better enable Buyer to react to a competing offer.

Buyer might require, in the event of breach, an obligation to pay fees such as the following:

- (c) In the event of Sellers' breach of this Paragraph 6, Sellers will jointly and severally reimburse Buyer's reasonable out-of-pocket costs and expenses incurred in the course of pursuing the Possible Acquisition (including, without limitation, reasonable legal and financial advisor fees)

and incurred up to and including the Termination Date or 90 days after the date of this letter, whichever is earlier.

Even if Sellers were to agree to such a provision, they might suggest: "The remedy provided in this Paragraph 6(c) will be Buyer's sole and exclusive remedy for Sellers' breach of its obligations under this Paragraph 6." Sellers also may request a cap on any amounts reimbursable under this provision. In the alternative, the parties often agree upon a specific liquidated damages amount in lieu of or in addition to expense reimbursement.

An aggressive Buyer may also require that Sellers pay a break-up fee or topping fee as recompense for the Buyer serving as a stalking horse that results in Sellers receiving a more attractive offer for the target. A topping fee is typically computed by reference to the amount by which a successful third-party offer exceeds the offer made by the Buyer. These types of fees are unusual in private transactions, generally being limited to public company acquisitions and bankruptcy sales, and Buyer may face considerable resistance from Sellers with respect to this type of provision. The actual formulation of this provision is highly variable.

## 7. CONDUCT OF BUSINESS

**Sellers shall cause the Acquired Companies to operate in the ordinary course and to refrain from any transactions outside the ordinary course of business.**

### COMMENT

Buyer will want to restrict Sellers from shifting assets or otherwise affecting the operations of the Acquired Companies in a way that may reduce Acquired Companies' value before specific provisions are put in place in a definitive agreement. This sample provision could be modified to require Sellers only to notify Buyer in advance of any extraordinary transactions or conduct outside the ordinary course of business, thereby providing Buyer with the opportunity both to learn promptly of such activities and to alert Sellers if Buyer believes such activities will have a negative effect on their negotiations toward a definitive agreement. Sellers may object to these levels of restraint on the operation of the Acquired Companies' business in the absence of any binding agreement on the terms of a sale or earnest money payments by Buyer. The sample provision may also be modified to detail more specific prohibitions or exclusions based on the particular concerns of the parties.

Sellers may be concerned about the overly restrictive nature of this covenant, particularly considering its duration. See commentary to Section 5.2 of the Model Agreement.

In any event, Buyer should take care not to involve itself too directly in the operation of the Acquired Companies' business prior to the signing of a definitive agreement. Such involvement may be a factor used by the court to determine that the parties intended the letter of intent to bind them to the proposed acquisition. See *Computer Systems of America, Inc. v. IBM Corp.*, 795 F.2d 1086 (1st Cir. 1986). *But see Skycom Corp. v. Telstar Corp.*, 813 F.2d 810 (7th Cir. 1987).

Buyer, particularly if a competitor of the target, would also be concerned about the antitrust implications of such involvement. See commentary to Sections 5.1 and 5.2 of the Model Agreement.

## 8. CONFIDENTIALITY

Except as expressly modified by the Binding Provisions, the Confidentiality Agreement entered into by the Company and Buyer on \_\_\_\_\_ (the “Confidentiality Agreement”) shall remain in full force and effect.

### COMMENT

Parties commonly enter into a confidentiality agreement prior to negotiating a letter of intent. If a confidentiality agreement between the parties was previously entered into and continues in effect, Paragraph 8 can be used. If not, the parties might deal with confidentiality by a binding provision in the letter of intent or by means of a separate agreement. See Ancillary Document A—Confidentiality Agreement.

## 9. HART-SCOTT-RODINO

Buyer and Sellers shall proceed, as promptly as is reasonably practical, to prepare and to file any notifications required by the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (“HSR Act”).

### COMMENT

Paragraph 9 adds a contractual obligation for both parties to jointly make appropriate Hart-Scott-Rodino filings, if required. Such filings will start the clock on the applicable waiting period, thereby reducing the time between the execution of the definitive agreement and the closing of the acquisition.

## 10. COSTS

Buyer and each Seller will be responsible for and bear all of its respective costs and expenses (including any broker’s or finder’s fees and the expenses of their representatives) incurred at any time in connection with pursuing or consummating the Possible Acquisition. Notwithstanding the preceding sentence, Buyer will pay one-half and Sellers will pay one-half of the HSR Act filing fees.

### COMMENT

Paragraph 10 establishes how the parties will allocate the legal and other fees and expenses in the transaction and the Hart-Scott-Rodino filing fee prior to the execution of a definitive agreement. The definitive agreement, if one is executed, will generally include a provision dealing with such fees and expenses. The division of the Hart-Scott-Rodino filing fee is pro-Buyer, since the fee is imposed on Buyer absent agreement to the contrary. Sometimes one of the parties has the leverage to have its fees covered by the other party (or the target) up to some specified maximum amount. See commentary to Section 1.1 of the Model Agreement.

Buyer may want to require a sharing arrangement, or otherwise address the cost of a Phase I or Phase II environmental audit, if one or more will be commenced prior to the execution of a definitive agreement.

## 11. TERMINATION

The Binding Provisions will automatically terminate upon the earliest of the following (the “Termination Date”): (i) \_\_\_\_\_, (ii) execution of the Definitive Agreement by all parties, (iii) the mutual written agreement of Buyer and Sellers, or (iv) written notice of termination by Buyer,

**for any reason or no reason, with or without cause, at any time; provided, however, that the termination of the Binding Provisions will not affect the liability of a party for breach of any of the Binding Provisions prior to the termination. Upon termination of the Binding Provisions, the parties will have no further obligations under this letter, except Paragraph 13 will survive such termination.**

#### **COMMENT**

Buyer's unilateral termination right could result in a demand by Sellers that the parties agree to negotiate in good faith toward the execution of a definitive agreement. If the parties specifically intend to require good-faith negotiations, they should so state. Such a provision has its dangers, though. Some commentators have suggested that the inclusion of a good-faith requirement in the binding provisions may encourage a court to construe a binding element to the nonbinding provisions as well. See Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 COL. L. REV. 217 (1987). Accordingly, it may be advisable (as has been done in the sample letter of intent) to avoid the good-faith requirement language and rely on a break-up or topping fee or some other protection for Buyer. The letter of intent could specifically exclude a duty of either party to negotiate any aspect of the transaction in good faith. Such a provision is unusual, however, since the language could be interpreted by business persons as equivalent to indicating an intent to operate in bad faith.

Sellers would negotiate for the shortest possible date to be filled in the blank, while Buyer would insert a later date.

Sellers may negotiate for their own termination right. In that event, Buyer might negotiate for the survival of certain Binding Provisions, e.g., Paragraph 6. Such a survival may be intended to discourage Sellers from terminating the Binding Provisions if Sellers' objective is to take another offer.

#### **12. EFFECT OF LETTER**

**The provisions of Paragraphs 1 through 4 of this letter are intended only as an expression of interest on behalf of Buyer, are not intended to be legally binding on any party or Acquired Company, and are expressly subject to the negotiation and execution of an appropriate Definitive Agreement. In addition, nothing in this letter should be construed as an offer or commitment on the part of Buyer to submit a definitive proposal. Except as expressly provided in Paragraphs 5 through 13 (or as expressly provided in any binding written agreement that the parties may enter into in the future), no past or future action, course of conduct, or failure to act relating to the Possible Acquisition, or relating to the negotiation of the terms of the Possible Acquisition or any Definitive Agreement, will give rise to or serve as a basis for any obligation or other liability on the part of the parties or any of the Acquired Companies.**

#### **COMMENT**

Paragraph 12 makes it clear that the parties do not intend to create a legally binding obligation with respect to Part One. A clear expression of this intent is desirable and, as noted in the preliminary note, courts have on occasion refused to give less precise words a nonbinding effect. For example, some cases have held language that the letter of intent is "subject to" a definitive agreement merely states a condition subsequent rather than the requisite intent not to be bound. See, e.g., *Computer Systems of America, Inc. v. IBM Corp.*, 795 F.2d 1086 (1st Cir. 1986); *Teachers Ins. & Annuity Ass'n v. Tribune Co.*, 670 F. Supp. 491 (S.D.N.Y. 1987); *Texaco, Inc. v. Pennzoil*

Co., 729 S.W.2d 768 (Tex. App. 1987), *cert. denied*, 485 U.S. 994 (1988). One of these cases also found that the parties had entered into a contract of preliminary commitment binding one another to negotiate in good faith, an obligation arising from the “subject to” language. See *Teachers Insurance & Annuity Ass’n.*, 670 F. Supp. at 500. The phrase “no past or future action, course of conduct, or failure to act relating to the Possible Acquisition . . . will give rise to or serve as a basis for any obligation or other liability on the part of any of the parties or any of the Acquired Companies” is an attempt to remove the possibility that oral communications or other actions can give rise to a binding obligation. The broad exculpatory language to relieve parties of any liability, should the other party claim that the nonbinding provisions are binding, is intended to allow a party to withdraw from the acquisition at any stage prior to the execution of a definitive agreement. Notwithstanding this precise language regarding future conduct and lack of liability, there will remain some risk that a court may give effect to oral communications and other actions in interpreting the intent of the parties. See the discussion in the Preliminary Note.

### 13. MISCELLANEOUS

#### COMMENT

See the Introduction to this Volume 2 and commentary to Article 12 of the Model Agreement for further discussion relevant to the miscellaneous provisions.

- (a) **Entire Agreement.** The Binding Provisions supersede all prior agreements, whether written or oral, between the parties with respect to its subject matter and constitute a complete and exclusive statement of the terms of the agreement between the parties with respect to its subject matter.

#### COMMENT

Paragraph 13(a) is intended to prevent any prior writings, understandings, discussions, or conduct from being integrated into or otherwise affecting the letter of intent.

- (b) **Modification.** The letter may only be amended, supplemented, or otherwise modified by a writing executed by the parties.
- (c) **Governing Law.** All matters relating to or arising out of a Possible Acquisition and the rights of the parties (sounding in contract, tort, or otherwise) will be governed by and construed and interpreted under the laws of the State of \_\_\_\_\_, without regard to conflicts of laws principles that would require the application of any other law.
- (d) **Jurisdiction; Service of Process.** Any proceeding arising out of or relating to a Possible Acquisition shall be brought in the courts of the State of \_\_\_\_\_, County of \_\_\_\_\_, or, if it has or can acquire jurisdiction, in the United States District Court for the \_\_\_\_\_ District of \_\_\_\_\_, and each of the parties irrevocably submits to the exclusive jurisdiction of each such court in any such proceeding, waives any objection it may now or hereafter have to venue or to convenience of forum, agrees that all claims in respect of such proceeding shall be heard and determined only in any such court, and agrees not to bring any proceeding arising out of or relating to a Possible Acquisition in any other court. Each party acknowledges and agrees that this Paragraph 13(d) constitutes a voluntary and bargained-for agreement between the parties. Process in any proceeding may be served on any party anywhere in the world.

- (e) **Counterparts.** This letter may be executed in one or more counterparts, each of which will be deemed to be an original copy and all of which, when taken together, will be deemed to constitute one and the same document, and will be effective when counterparts have been signed by each of the parties and delivered to the other parties. A manual signature on this letter whose image shall have been transmitted electronically will constitute an original signature for all purposes. The delivery of copies of this letter, including executed signature pages, by electronic transmission will constitute effective delivery of this letter for all purposes.

If you are in agreement with the foregoing, please sign and return one copy of this letter, which thereupon will constitute our understanding with respect to its subject matter and a binding agreement with respect to the **Binding Provisions**.

**COMMENT**

The signatures are intended only to indicate agreement to the binding provisions and preserves the argument that the signatories never intended to be bound by the nonbinding provisions of Part One.

Very truly yours,

**BUYER:**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

Agreed to as to the **Binding Provisions**  
on \_\_\_\_\_.

**SELLERS:**

\_\_\_\_\_  
[1]

\_\_\_\_\_  
[2]

...

\_\_\_\_\_  
[8]



## SHORT FORM LETTER OF INTENT

[DATE]

Seller [1]

Seller [2]

...

Seller [8]

Ladies and Gentlemen:

This will set forth the preliminary intention of the parties as to general terms upon which \_\_\_\_\_ ("Buyer") would consider acquiring from you ("Sellers") all the outstanding capital stock of \_\_\_\_\_ ("Company").

1. Upon the closing of the sale, Buyer would acquire all of the capital stock of Company from the shareholders of Company in exchange for an aggregate payment at closing of \$\_\_\_\_\_ in cash, subject to adjustment, and promissory notes of Buyer in the aggregate principal amount of \$\_\_\_\_\_. Each Seller would receive cash equal to \$\_\_\_\_\_ per share owned, subject to adjustment, and a promissory note in the principal amount of \$\_\_\_\_\_ per share. Our willingness to consider this proposed transaction is conditioned on the willingness and eventual agreement of all shareholders of the Company to sell on terms acceptable to Buyer.

2. As promptly as practicable and in any event by \_\_\_\_\_, Buyer's counsel will prepare an initial draft of a definitive stock purchase agreement ("Purchase Agreement") and other related agreements for review by you and your counsel. The draft Purchase Agreement will provide for customary representations and warranties, covenants, conditions to closing, escrows, and indemnities. The parties will endeavor to negotiate and execute a final definitive Purchase Agreement on or before \_\_\_\_\_, and to close the sale on or before \_\_\_\_\_. The parties anticipate that prior to the execution of any definitive Purchase Agreement, Buyer will have the opportunity to conduct due diligence of the Company and you will have the opportunity to conduct due diligence of Buyer.

3. It is understood that before the parties would consider entering into a definitive Purchase Agreement, (a) Buyer shall have been satisfied with the results of its due diligence investigation of Company, and (b) Buyer shall have become satisfied that it is able to borrow \$\_\_\_\_\_ million of the cash portion of the purchase price on terms acceptable to Buyer.

4. It is agreed that each party shall bear its own legal, accounting, investment banking, and other expenses in connection with the negotiation, documentation, and closing of the acquisition, whether or not a closing occurs. Any expenses borne by Company would be deducted from the purchase price in the event of a closing. Each party represents that it has not engaged any broker or finder in connection with the acquisition.

5. The parties agree that this letter is merely an expression of intent and neither party is under any legal obligation to the other unless and until a definitive Purchase Agreement is executed, except for (a) the provisions of paragraph 4, this paragraph 5, and paragraph 6 and (b) the

confidentiality agreement executed by Buyer with respect to the confidential information of Company.

6. It is agreed that any party may cease pursuit of the contemplated transaction at any time for any or no reason. No party is obligated to negotiate in good faith.

If the foregoing is in accordance with your understanding, please execute and return the enclosed copy of this letter.

Very truly yours,

---

Buyer

Agreed to as to Paragraphs 4, 5 and 6.

---

Seller 1

...

---

Seller 2

COMMENT

The Short Form is intended to satisfy a preference of the parties to document the status of their negotiations in a simpler, less formal writing than the more comprehensive Long Form. The Short Form could be prepared and negotiated upon very short notice. The Short Form could easily be expanded to include more details on nonbinding provisions or to add binding provisions such as exclusivity. This form also may appear to be more user-friendly and less intimidating to a target in the early stages of its first exposure to the acquisition process than the Long Form.

Some lawyers, rather than using a signed letter format of any kind, prefer a term sheet or "heads of agreement" which may or may not be signed or initialed by the parties and simply lists the principal business terms upon which the parties are in agreement and are to be the bases for further negotiation of a definitive purchase agreement. Even if unsigned, the parties should include on the term sheet a disclaimer of intention to be bound or legal obligation to each other of the sort contained in paragraph 12 of the Long Form or paragraph 5 of the Short Form, as there is a possibility that a court might otherwise view the points of agreement on the term sheet as written evidence of a meeting of minds sufficient to form a binding agreement, particularly when supported with oral testimony or e-mails or other informal writings.