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## Ask a VR Intermediary



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### **How Should You Negotiate the Letter of Intent?**

A "Letter of Intent" is a pre-contractual written instrument that defines the respective preliminary understandings of the parties about to engage in contractual negotiations. In most cases, such a letter is not intended to be binding except under very unusual circumstances, and then only for certain limited provisions.

The letter of intent crystallizes in writing the basic terms of the transaction, which up to that point have been the subject of oral negotiations between the parties. The letter will set forth the proposed structure of the transaction, the price and how it will be paid, the terms of notes or stock to be conveyed as part of the price, and other important, but general, features of the transaction such as special accounting or tax considerations.

The Letter of Intent also sets forth the preconditions to completing the transaction, including the completion of due diligence and the execution of a mutually satisfactory purchase or acquisition agreement.

Most Letters of Intent specifically state that the letter does not create a binding obligation to close the transaction. But simply declaring that the letter is non-binding in a given area may not be enough to make it non-binding. The legal test for the binding character of an agreement is the intent of the parties

as determined from all the circumstances. For this reason, all parties involved in a transaction should treat the letter, in all possible respects, as a non-binding memorandum of the terms of a proposed transaction. However, the Letter of Intent is usually intended to create binding obligations with respect to confidentiality, the bearing of expenses, and any “no-shop” agreement the parties have reached.

Except in rare cases, use of a Letter of Intent is recommended. **First**, the letter contains certain binding provisions that can give both parties a clearer understanding about the basic terms of the deal. For example, experienced buyers do not want to spin their wheels while the seller shops an offer around to other potential buyers. Thus, the buyer may wish to obtain a no-shop agreement from the seller, a provision requiring the seller to refrain from negotiating with other parties for a specified period of time. The Letter of Intent offers a way to obtain such an agreement early in the negotiations.

**Second**, the parties will have to expend a considerable amount of time and money to complete due diligence and negotiate and draft a purchase agreement. To do so without a clear understanding of the basic terms of the transaction may prove to be a costly error. Thus, the parties may enter into a Letter of Intent agreement before incurring the expense of negotiating an acquisition or purchase agreement in an attempt to provide an additional level of assurance that negotiations will be successful.

**Third**, although the document is technically not a binding agreement, the execution of the letter often has the effect of creating a moral commitment to use good-faith best efforts to consummate the transaction in accordance with the outlined terms. After announcing the execution of the Letter of Intent, neither party wants to be the one to walk away without a good reason. A carefully drafted letter can be used to establish initial positions and can be an integral part of making the deal work.

Letters of Intent are usually executed after the buyer has completed its basic financial due diligence but before it embarks on its major legal due diligence. This timing reduces the likelihood of incurring substantial expenses before the parties have reached an agreement in principle about basic business terms.

Many times the buyer and seller will have reached an agreement and set it down in a Letter of Intent, the buyer will make signing the actual agreement conditional on the occurrence of an external event, such as obtaining financing.

Though complicated for the average individual buyer to draft, the professional business intermediary will work to have a document drafted that makes the transaction work for the involved parties. The serious buyers should consider professional representation a must; no matter what size business is being acquired.