

Overview of Letters of Intent

File C5-85

Letters of intent are used in the course of negotiating terms for a transaction that serve a combination of functions. One, they signify a commitment to the transaction by setting out generally agreed to terms of the transaction. This allows the parties to negotiate major issues without being distracted by issues that are not likely to be “deal-killers.” Two, they typically include a timeline and method for resolving open issues. Because they typically contain both binding and nonbinding provisions, parties must be express about which provisions are binding. If not, a court will likely hold that the letter is merely an agreement to agree, at least as to the definitive agreements contemplated by the letter, and is therefore unenforceable.

This summary will discuss in more detail the terms of File C5-86 [Sample Letter of Intent](http://www.extension.iastate.edu/agdm/wholefarm/pdf/c5-86.pdf), www.extension.iastate.edu/agdm/wholefarm/pdf/c5-86.pdf, and the legal rights and obligations created under it, as well as provisions that could be adapted to specific circumstances and arrangements.

This summary does not constitute legal advice. Letters of intent are not always a necessary or desired step in the negotiation process. Parties negotiating and contemplating entering into a letter of intent should consult with competent legal advisors.

Provisions of the Agreement and Duties and Obligations Created

Because a letter of intent will likely include both binding and nonbinding terms, it is important for the parties to understand the rights and obligations that may be created by a letter of intent. Below is a discussion of some of the issues to consider when negotiating and drafting a letter of intent to be sure it accurately reflects the intention of the parties.

Introductory Provisions

The first portion of a letter of intent should accurately and succinctly define the parties to the letter, summarily describe the proposed transaction, and

provide an overview of the binding and nonbinding provisions of the letter.

In Information File C5-86, [Sample Letter of Intent](http://www.extension.iastate.edu/agdm/wholefarm/pdf/c5-86.pdf), www.extension.iastate.edu/agdm/wholefarm/pdf/c5-86.pdf, it is expressly provided in this introductory section that “the letter as a whole and paragraphs 1–4 of Part One in particular, do not and shall not constitute a legal and binding obligation....” This means that, as to the Definitive Agreements, the sample is merely an agreement to agree. Courts have consistently held that an agreement to agree is not binding on the parties. As to the method of negotiating and preparing the definitive agreements, including confidentiality obligations, due diligence, deposit payments, etc., those terms should be made binding and are provided in Part Two of Information File C5-86, [Sample Letter of Intent](http://www.extension.iastate.edu/agdm/wholefarm/pdf/c5-86.pdf), www.extension.iastate.edu/agdm/wholefarm/pdf/c5-86.pdf. Each of the sections of Part One and Part Two are discussed below.

Part One: Nonbinding Statement of Understanding

- **Proposed Transaction.** This section describes the proposed transaction in more detail, but should make the entering into of any definitive agreement subject to conditions applicable to the transaction. Typically, due diligence, financing, and compliance with applicable laws are three conditions to entering into the definitive agreements.
- **Consulting Agreement; Non-Compete; Board Seat.** The Sample Letter of Intent form contemplates the acquisition of all of the outstanding stock of a closely held corporation. Because of the selling shareholders’ experience in the industry, the acquirer intends to retain them as consultants for a specified period of time so long as they are willing to enter into a non-compete agreement. Obviously, this will not be the case for every transaction, but demonstrates the issues that can be covered by a letter of intent, and serves as a model if this situation did arise.

Reviewed June 2023

- **Preparation of Definitive Agreements.** Variations of this section should be included in every letter of intent. It provides a general description of the method by which the parties will negotiate the definitive agreements and the general terms of those agreements. Remember, however, that this section is an agreement to agree and is not binding on the parties. The final terms of the general issues listed in this section are still subject to agreement by the parties.
- **Conditions Precedent to the Closing.** This section describes in detail the conditions to closing. As previously indicated, satisfactory due diligence, successful financing, and compliance with applicable laws and regulations are standard conditions. Other conditions include obtaining the necessary consents from lenders, shareholders, etc., the delivery of legal opinions, and the absence of adverse change to the condition of a party. These conditions could be varied and should be drafted specific to the proposed transaction.

Part Two: Agreements of the Parties Regarding the Procedures for Negotiation and Preparation of the Definitive Agreements

- **Due Diligence.** Whether a transaction reaches closing often times depends on the results of the due diligence. Because of its important role, parties will typically agree to what information will be provided and by whom and in what timeframe. It is common for the target to require that the requests for information not contemplated by the letter of intent be reasonable.
- **Confidentiality.** The parties should agree to the level of confidentiality that will be required regarding the terms of the letter of intent and their ongoing negotiations. Also, because information will be exchanged during due diligence and during the negotiations, the parties should agree on what information is confidential. In most cases, the parties will expressly state that all information is confidential unless otherwise provided and that the obligation of confidentiality survives the term of the letter.
- **Public Disclosure.** The parties should determine when and if the public will be made aware of

the existence of the letter and the proposed transaction. This will help prevent any premature disclosure that may jeopardize the transaction or the parties' alternatives should the transaction not reach fruition. It is typical for the parties not to want any public disclosure until the definitive agreements have been signed. The parties may also find it in their best interests to agree on how the proposed transaction is made public.

- **Disclaimer of Liabilities.** Typically, parties will desire to limit their liability in the event the transaction is not completed. The degree of each party's liability is a point of negotiation.
- **Termination.** The letter of intent must have a termination provision. The Sample Letter of Intent form allows either party to unilaterally withdraw at any time with proper notice. This unilateral right to terminate, however, is subject to losing the deposit payment as discussed below.
- **Exclusive Opportunity; Deposit.** A deposit is not always a subject of a letter of intent. However, in the Sample Letter of Intent form, the acquirer agreed to pay a deposit so that it would have the exclusive opportunity to acquire the stock for a specified period of time. When deposits are required, and the transaction closes, the deposit is typically applied to the acquisition price.

Consequences of Breaching a Letter of Intent

If a party breaches a binding provision of a letter of intent, that party will likely be subject to both equitable and monetary damages. For example, if the party breaches the obligation of confidentiality, a court may grant an injunction against the further disclosure of that information.

[Sample Letter of Intent](http://www.extension.iastate.edu/agdm/wholefarm/pdf/c5-86.pdf), www.extension.iastate.edu/agdm/wholefarm/pdf/c5-86.pdf

Original author Joe R. Thompson
extension.iastate.edu/agdm/

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