4 Things to Know About Letters of Intent

By Austin D. Potenza II (http://www.axial.net/author/austinpotenza/), May, Potenza, Baran & Gillespie | November 15, 2016

Co-author: Shruti Gurudanti

In the process of negotiating and structuring deal, one of the watershed steps is signing a Letter of Intent ("LOI"). Signing an LOI does not mean that the deal is finalized, but can be an important tool to set the tone, schedule and basic terms of the deal, and a way for the buyer and seller to gauge each other's willingness to proceed.

Below are four major considerations for anyone executing an LOI:

1. LOIs aren't mandatory.

If the parties are confident that they intend to do a deal, and are comfortable with the material terms, they may choose to skip the LOI and go directly to the preparation of definitive transaction documents. However, depending on the dynamics of a transaction, the parties may wish to begin the process with an LOI. Although one of the most common reasons for executing an LOI is to preserve the confidentiality of the process and the sensitive information that will be exchanged, a simple confidentiality agreement will often suffice for that purpose.

2. LOIs set procedures for due diligence.

In situations wherein the parties are not yet comfortable spending the time and resources to conduct due diligence and draft complex deal documents, the LOI can be a very good investment. An LOI can be used to set expectations around deal structure, scheduling, and other big picture deal points. Material terms that are essentially deal-breakers can be resolved early. Where due diligence is required, the letter of intent can specify the manner in which due diligence will be conducted, including the nature of information that will be disclosed and the manner in which it will be disclosed.

3. LOIs help protect all parties in the deal.

In order to prevent a bidding war, or to allow the buyer an exclusivity period in which to conduct its due diligence, an LOI can include a "no-shop" clause that prohibits either or both sides from approaching third parties for a limited period of time. Likewise, in order to protect a seller from wasting time, money and effort, an LOI may include a break-up fee that is paid if the buyer cancels the transaction for an unpermitted reason.

Many of these points (and more, of course) can be covered in a definitive agreement that provides for a delayed closing (i.e., a period of time between when the parties sign the agreement and when they finalize the transaction). However, the parties may want to set some ground rules before incurring all of that expense. This is where an LOI comes in.

4. LOIs are considered formal legal documents.

It is important to differentiate between what parts of an LOI are intended to be enforceable, and what parts aren't. Examples of enforceable sections include clauses around confidentiality, no-shop, or break-up fees. Although price and terms typically wouldn't be included among the enforceable provisions, they set an expectation that is difficult to change absent a good reason.

If the circumstances of the deal warrant, an LOI can be a valuable tool to save time and money. Because it is an important legal document, be sure to have it reviewed by a lawyer with experience in M&A transactions. It also makes sense to have your CPA review it for tax consequences.

About the Authors:
This article was originally published on **My Vistage (https://my.vistage.com/community/networks/deal/blog/2016/10/19/a-short-primer-on-letters-of-intent)**.

Austin Potenza (http://www.maypotenza.com/attorneys/austin-d-potenza-ii/) *is a founding shareholder of May, Potenza, Baran & Gillespie and serves on the Firm's Management Committee. He is the head of the Corporate/Transactional Practice Group. Austin's practice focuses on corporate law, commercial transactions, start-ups, mergers and acquisitions, and tax planning. Austin is a certified tax law specialist.*

Shruti Gurudanti (http://www.maypotenza.com/attorneys/gurudanti-shruti/) *is an associate of May, Potenza, Baran & Gillespie. She is in the Corporate/Transactional Practice Group. Shruti is developing her practice in the area of Corporate Law, Mergers and Acquisitions, and Emerging Businesses.*

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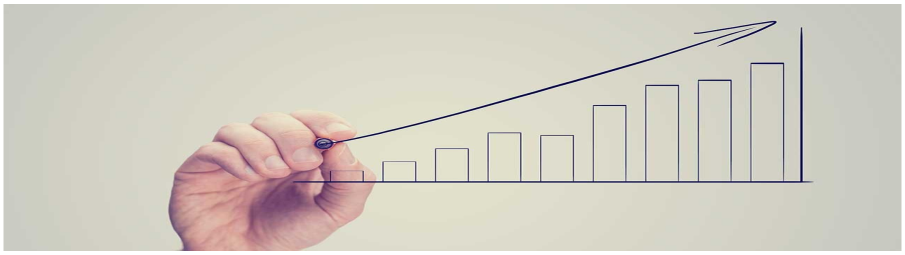

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