



## Corporate Law Notice (September 2010)

### Letter of Intent

One of the first important steps in negotiations about the sale of a business is drafting a Letter of Intent (LoI), sometimes called a Memorandum of Understanding (MoU).

#### **1. Purpose of an LoI / MoU**

An LoI is a useful tool that helps the buyer and seller structuring the proposed transaction. It specifies which terms are binding (typically those related to negotiating, such as confidentiality, access and expenses) and which are not (those of the proposed transaction itself).

The LoI merits both parties' careful consideration, because its terms will largely direct the course of the negotiations. Putting together an LoI allows the parties to articulate the status of their discussions and identify gaps or deal breakers. That should give them a sense of the likelihood of success before either has committed much time or expense.

Resolving difficult issues at an early stage of negotiations can make negotiating an agreement easier, enabling both parties to devote more energy to the key issues. LoI's also protect against memory loss: the terms are all in writing, and parties generally feel obligated to follow them, even if they are legally nonbinding.

#### **2. Terms**

An LoI's terms strongly influence the negotiation of a final purchase agreement. A poorly drafted LoI can result in legal dispute and even litigation in which one party tries to bind the other party to obligations it did not intend to be bound to.

##### **a) Seller's view**

An LoI often includes a so-called no-shop provision that prevents the seller from selling or negotiating a sale for an agreed period of time. Such an LoI, together with the buyer's review of the target company, can put the seller at a negotiating disadvantage.

Accordingly, sellers want to detail transaction terms: the assets and liabilities involved, the purchase price, the limitations of the seller's liability, conditions to closing, how employment issues will be handled, and other material agreements, such as noncompetes. A seller will try to limit the scope of a no-shop clause and define the buyer's rights to speak with its employees and others about the transaction.

##### **b) Buyer's view**

Buyers, on the other hand, have different interests, making the final LoI a balancing act. Buyers generally want to have a strict no-shop provision. The buyer does not want the seller

introducing other potential purchasers while the buyer is spending time and money on due diligence and obtaining funding. The buyer seeks the seller's commitment to allow access to the target company's records and operations.

Since the typical buyer negotiates the Lol before performing its primary due diligence, it is important that the buyer makes sure certain deal terms remain flexible. Terms such as price adjustments and liability may be affected by the results of due diligence.

### c) Binding and nonbinding provisions

Both parties are advised to make clear which agreements are binding and which are not. When drafting an Lol, the parties should specifically state which sections are binding and that no other provisions are binding, unless a final written agreement is reached.

Binding Lol provisions typically are those relating to the negotiating period, such as no-shop and right-of-access clauses, and generally terminate at the end of the expected negotiation period. Some with no termination date are also binding, e.g. provisions that protect confidentiality or require each party to bear its own expenses. A buyer may request that the seller operates the business in the ordinary course during negotiations, which sellers often resist, instead perhaps agreeing to notify the buyer of any material action outside of the ordinary course.

Nonbinding provisions address important transaction terms issues. The buyer and especially the seller need to understand e.g. which assets will be purchased at which price and which liabilities will be assumed.

## 3. Conclusion

Drafting an Lol requires a lot of thought and careful planning. But if prepared well, it can lead the buyer and seller to a successful deal.

Our specialists in corporate and commercial law are happily available to help with any issues concerning Letters of Intent and the sale of businesses:



**Dr. Theodor Seitz, LL.M. (Harvard)**

Rechtsanwalt, Steuerberater  
Specialist in corporate law  
Attorney-at-law (N.Y.)

[TSeitz@seitz-partner.de](mailto:TSeitz@seitz-partner.de)  
+49 821 345 85 - 31



**Dr. Christoph Knapp**

Rechtsanwalt  
Specialist in corporate law

[CKnapp@seitz-partner.de](mailto:CKnapp@seitz-partner.de)  
+49 821 345 85 - 11