Letters Of Intent Defined

Letters of Intent, sometimes referred to as “memorandums of understanding,” are frequently used in media transactions and are pre-contractual documents that set forth certain basic terms upon which parties intend to enter into binding definitive agreements. Letters of Intent are usually intended to be non-binding “agreements to agree” that confirm and solidify handshakes. There are, however, (i) certain elements that may be binding on a proposed buyer or seller, or both, and (ii) courts that have held that a Letter of Intent is or has become a binding agreement even though a definitive agreement has not been signed by the parties. This article will briefly discuss the purposes and elements of Letters of Intent and demonstrate one of the major pitfalls of using Letters of Intent as illustrated by recent case law. Letters of Intent should be treated seriously and, from a seller’s perspective in particular, should contain appropriate provisions regarding their non-binding nature in order to avoid some of the pitfalls described below.

Purposes And Elements

One of the main reasons parties may enter into a Letter of Intent is to spell out each party’s expectations with respect to the essential terms of the proposed deal, in addition to price, early on in a transaction. Additional reasons include (i) to demonstrate the parties’ commitment to the transaction; (ii) to provide preliminary documentation to lenders or governing boards; (iii) to facilitate public notice of the fact of the transaction for publicly traded parties; (iv) to determine who will draft certain documents; and (v) to set a timeframe for the completion and execution of the definitive agreement(s).

To achieve the foregoing purposes, a typical Letter of Intent will often set forth the following, among other things:

- A description of assets that will be included in the proposed transaction, and also those assets to be excluded;
- The purchase price and good faith deposit, if required, to be paid by the proposed buyer;
- The exclusivity period during which the proposed seller will be required to deal exclusively with the proposed buyer while negotiations of the definitive agreement(s) and due diligence are under way;
- The due diligence period for the proposed buyer;
- Each party’s obligation to keep the information it acquires during negotiations confidential, and a prohibition on making any public announcements regarding the proposed transaction unless otherwise required;

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A list or description of the required definitive document(s);
• The target or outside date for the execution and delivery of the definitive agreement(s);
• Certain additional important terms and conditions of the transaction, such as the time required for FCC consent and the proposed representations, warranties and covenants, or, as is the more common practice, a statement that the terms and conditions set forth in the definitive agreement(s) will be customary to transactions of similar type and size;
• The allocation of expenses so that each party is responsible for its own costs and expenses related to the transactions, including fees to financial advisors and attorneys;
• The governing law; and
• The provisions of the Letter of Intent that will be binding upon the parties and any that should survive the termination or expiration of the Letter of Intent.

Parties usually state that only limited provisions of the Letter of Intent will be binding. For example, from a proposed buyer’s perspective, the exclusivity provision will likely be one of the most important binding provisions in the Letter of Intent because it provides comfort to the proposed buyer that the proposed seller can not simultaneously “shop” the transaction to another potential buyer. From a proposed seller’s perspective, it is in its best interest to narrowly tailor the scope and length of the exclusivity provision and to ensure that the confidentiality provision is binding to protect any information that reveals during the due diligence review conducted while the Letter of Intent is in effect. Additional provisions that should be binding and that are in the best interests of both parties include the definitive agreement(s), governing law and allocation of expenses provisions.

A sample Letter of Intent provision that refers specifically to its non-binding nature may read as follows:

The parties hereto acknowledge that this letter does not contain all of the material matters, terms and conditions necessary in order for the purchase and sale to be binding. Therefore, the obligations of the parties hereto to consummate the purchase and sale are subject to the negotiation and execution by the parties hereto of the Definitive Agreements by [a specified date]. Accordingly, this letter is intended solely as a basis for further discussion and is not intended to be and does not constitute a legally binding agreement; provided, however, that the provisions set forth in paragraphs 4, 5, 7 and 8 below, and this paragraph shall be binding upon the parties hereto and, only with respect to paragraphs 7 and 8, shall survive the termination hereof. If the Definitive Agreements are not executed and delivered by the parties on or before [the specified date] for whatever reason, either party may terminate this letter upon written notice to the other party. Time is of the essence in the performance of this letter.

The sample language above clearly indicates that the parties intend to be bound only upon the execution of the definitive agreements. However, courts have held that the intent of the parties controls whether or not a Letter of Intent is or has become enforceable as a binding agreement if a “meeting of the minds” of the parties on all material terms and conditions has occurred. It is therefore in the parties’ best interests to remove any ambiguity from the Letter of Intent and clearly state their intention. An example of what may occur when the intent of the parties is not clear is outlined below in [cited case].

Pitfall

The major pitfall of using a Letter of Intent is that a court may impose liability on a party based on the Letter of Intent when the parties did not originally intend for it to be a binding agreement.

In Turner Broadcasting, Turner and McDavid were negotiating a transaction where Turner would sell two sports teams to McDavid for $96 million. On April 30, 2003, the parties signed a Letter of Intent which included a 45-day exclusivity period. The Letter of Intent stated that the parties would not be bound unless and until the parties executed the definitive agreements. The Letter of Intent expired at the end of the exclusivity period during the course of negotiations, and the confidentiality provision was the only provision that survived such expiration, according to the terms of the Letter of Intent. Turner, contrary to McDavid’s request, did not extend the Letter of Intent because the parties were “very, very close to a deal.” On July 30, Turner’s CEO stated, “We have a deal.” On September 12, Turner’s principal negotiator stated, “The deal is done. Let’s get documents we can sign.” On the same day, Turner signed an agreement with Atlanta Spirit – another bidder Turner had commenced negotiations with back in August. McDavid sued Turner Broadcasting for breach of an oral contract and promissory estoppel.

The trial court ruled in favor of, and entered a $281 million verdict for, McDavid. The appellate court upheld its ruling, citing that the parties intended to be bound based on their conduct, specifically referring to the “We have a deal” and “The deal is done” statements, and the language in the Letter of Intent. The court went on to explain that even though the Letter of Intent stated that the parties would not be bound absent the written definitive agreement, such provision did not survive the termination of the Letter of Intent. The court also mentioned that the survival of the confidentiality provision was expressly written into the Letter of Intent, indicating that if the definitive agreement provision was meant to survive the termination or expiration of the Letter of Intent, the Letter of Intent would have expressly stated the same. The court stated that even though the parties’ contemplation of the written definitive agreement was “strong evidence that [they] did not intend to be bound by a preliminary agreement,” it was in the jury’s discretion to find that there was a binding oral contract based on the conflicting evidence.

Based on a court’s ability to use a Letter of Intent to bind a party to a transaction without the execution of a definitive agreement as illustrated by Turner Broadcasting (and the high-profile Texaco, Inc. v. Pennzoil Co., 729 S.W.2d 768 [Tex. App. Houston, 1st Dist. 1987] case that came before it), parties should take extra precaution and consult counsel before executing a Letter of Intent.