

Letters Of Intent That Work

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Legal Briefs: Supply Management's Legal Issues

Developing one of these documents can be boiled down to one basic rule: Simply let your "yes" mean "yes," and your "no" mean "no."

Letters of intent are historical fixtures in the world of contracting. Yet, in recent times, their use has increased dramatically. This increase is due to several factors, including, but not limited to, the complexity of modern-day contract negotiations and the frequently compressed timeframes under which contracting parties now operate. Given the significant role that letters of intent play in today's contracting environment, it is important for parties using these instruments to fully understand their nature and the potential pitfalls their use may encompass.

A letter of intent (LOI) can be defined as a precontractual document used to express expectation of contract formation in the future. When properly drafted, the LOI should create no binding obligation on either party. These instruments are often prepared unilaterally by one party, but frequently signed by both. Letters of intent tend to exist on a sliding scale with regard to the levels of commitment — from those that simply serve as an agreement to further negotiate, to those that are, in reality, full-blown contracts and letters of intent in name only. Although the types and potential uses of letters of intent are limitless, these instruments generally fall into one of the following categories:

- **Assurance letters of intent** indicate a serious intention to advance negotiations. An assurance letter of intent might be used to: express an intent to place an order; form a joint bidding or teaming arrangement; demonstrate exclusivity in negotiations; or show that progress is being made toward a mutually beneficial end.
- **Framework letters of intent** serve as a guide for future negotiations, and may set forth or define: party responsibilities for various aspects of the negotiation process; dates or milestones in negotiations; issues subject to negotiation; or the scope of the effort to be undertaken.
- **Publicity letters of intent** are used to make a public announcement, such as announcing an anticipated corporate merger before the merger is actually consummated, or to provide publicity for negotiations benefiting the parties.
- **Memorialization letters of intent** are used to record preliminary or partial agreements; to define areas still subject to negotiation; or to evidence a moral commitment to a particular course of action.

- **Binding contracts** are legally enforceable written or oral agreements between two or more competent parties that define a job or service to be performed.

Avoid The Pitfalls Of Letters Of Intent

By design, true letters of intent merely express a party's commitment to engage in a course of action without actually creating a present contractual obligation to do so. In practice, however, it is common, particularly after a deal has fallen through, for one of the parties to argue that a letter of intent was, in fact, a binding contract. Herein lies the problem with letters of intent — parties to a letter of intent typically expect the other party to be bound by the instrument, but do not expect to be bound themselves! Such an expectation is disingenuous, and potentially dangerous.

As a general rule in the United States, Great Britain and other common-law countries, where law develops or derives primarily through judicial decisions, an incomplete agreement or an "agreement to agree" is not enforceable. Accordingly, true letters of intent will not be enforced by these jurisdictions the way a contract would be, because they do not state all essential terms of the transaction and are merely agreements to enter into some future contract.

However, if a letter of intent is drafted such that it resembles a full-fledged contract, a court, even in a common-law country, might decide to treat it as such. Moreover, in civil-law countries, where statutes are the primary source of law, such as France or Germany, there is legal authority for the idea that a few provisions in a letter of intent may be binding, despite the fact that the instrument as a whole is not.

When determining whether a letter of intent is a binding contract or a nonbinding "agreement to agree," U.S. courts usually consider two factors:

1. Whether the objective intention of the parties was to form a binding agreement (as inferred from the language of the letter of intent and the actions of the parties); and
2. Completeness of the agreement (such as, does it state or imply all material terms; has it been performed; is the transaction simple or complex; does it reference a future agreement).

Most of the time, courts will honor a statement in a letter of intent that the instrument is subject to future agreements, or is incomplete and intended to be nonbinding. However, U.S. courts have construed preliminary agreements that expressly state that they are subject to the execution of a future contract as enforceable contracts in and of themselves when the foregoing factors suggest that such a result was the true intention of the parties.

The rules governing enforceability of letters of intent as binding contracts are ambiguous in the United States, and in most other countries. Different U.S. and foreign courts might weigh the foregoing factors differently in determining whether one or both of these factors are present. Therefore, when providing letters of intent to, or receiving them from, parties outside the United States, businesses should seek legal counsel from an attorney who is knowledgeable regarding such matters in the applicable foreign jurisdiction.

Know What You Want And Say What You Want

Before drafting any letter of intent, make sure you have a clear picture of what you want to accomplish by using the instrument. For example, decide whether you want the letter of intent to be binding or nonbinding, and make sure the letter of intent clearly reflects the choice. If you want the letter of intent to be subject to the execution of a subsequent finalized contract, say so, and verify that timing considerations actually allow a follow-on agreement to be negotiated later. Moreover, if such is your intent, avoid discussion and inclusion of terms in your letter of intent that will just end up in the follow-on agreement. Remember, the more a letter of intent looks like a contract, the more likely it is one.

Partially Binding Letters Of Intent

It is not uncommon for contracting parties to try to sneak one or two terms into a letter of intent that they intend to be binding when the rest of the instrument is not. This is most often seen with clauses pertaining to confidentiality, allocation of costs, choice of law and exclusivity of negotiations. In civil-law countries, such as France and Germany, these few provisions may be binding despite the fact that the letter of intent as a whole is not. In common-law countries, like the United States or Great Britain, that take the "all or nothing" approach to enforcing terms in a letter of intent, the provision will likely not be enforceable. Nevertheless, regardless of the particular country, there are no guarantees. Accordingly, if there are particular preliminary matters that the parties actually agree on and wish to be binding, the parties should plainly specify in the letter of intent or draft a separate binding agreement to address those terms.

Conclusion

Letters of intent can be useful tools, but should only be used after careful consideration of the intended purpose, what will occur if the parties never negotiate a fully integrated final agreement and the dangers that can result from failing to draft to accurately express party intentions. In using letters of intent, or for that matter any contracting instrument, remember to simply let your "yes" be "yes," and your "no" be "no."