



## Understanding the Types of Letters of Intent and Avoiding the Common Pitfalls Associated with Their Use

A letter of intent can be defined as a pre-contractual written instrument reflecting preliminary agreements or understandings of one or more parties to a future contract. 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 regards 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:** These are used to indicate a serious intention to advance negotiations. An assurance letter of intent might be used to: (i) express intent to place an order, (ii) form a joint bidding or teaming arrangement, (iii) demonstrate exclusivity in negotiations, or (iv) show that progress is being made towards a mutually beneficial end.
- **Framework Letters of Intent:** These serve as a guide for future negotiations, and may set forth or define: (i) party responsibilities for various aspects of the negotiation process, (ii) dates or milestones in negotiations, (iii) issues subject to negotiation, or (iv) scope of the effort to be undertaken.
- **Publicity Letters of Intent:** These 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:** These 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:** These are used to define the legal obligations, and are letters of intent in name only.

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, an incomplete agreement or an “agreement to agree” is not enforceable. Accordingly, true letters of intent will not be enforced by an American court 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 might decide to treat it as such.



## **Understanding the Types of Letters of Intent and Avoiding the Common Pitfalls Associated with Their Use, *continued from page 1***

When determining whether a letter of intent is a binding contract or a non-binding “agreement to agree,” American 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 (i.e., does it state or imply all material terms, has it been performed, is the transaction simple or complex, and 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 non-binding. However, American 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 American and foreign courts might weigh the above factors differently or consider other issues 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 that is knowledgeable regarding such matters in the applicable foreign jurisdiction.

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, consider whether you want the letter of intent to be binding or non-binding, 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 that 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.

In civil law countries, such as France and Germany, there is some 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. In common law countries, like the United States or Great Britain, courts tend to take an “all or nothing” approach to enforcing terms in a letter of intent. Still, 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 general, this is an unadvisable practice when drafting letters of intent in a common law country, unless the parties are unambiguous regarding those clauses that are enforceable and those that are not. If there are particular preliminary matters that the parties actually agree on and wish to be binding, the parties may draft a separate binding agreement to specifically address those terms.



## **Understanding the Types of Letters of Intent and Avoiding the Common Pitfalls Associated with Their Use, *continued from page 2***

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.

### **Basic Blocking and Tackling for Requirements Contracts**

Sometimes, it can be advantageous for a company to contractually commit to purchasing all or a specified percentage of its requirements for a particular product or component from a single supplier. These kinds of agreements are referred to as requirements contracts. Requirements contracts typically arise in situations where a supplier is willing to offer more favorable contract terms and/or pricing to a potential customer, if the customer is willing to guarantee a certain volume of its demand for an item will be purchased from the supplier. From the buyer's perspective, there are a few basic concepts to keep in mind when drafting these kinds of contracts.

Regardless of whether the buyer is committing to purchase all or just a portion of its requirements for a product from the supplier, the contract needs to allow the buyer to go to an alternate source, if the supplier is unable to provide the product by the delivery date specified in the buyer's purchase order. The buyer should not allow itself to be put in a situation where it is contractually bound to buy from the supplier, when everyone knows the supplier cannot meet the requested delivery date. Addressing this situation in the contract allows the buyer to avoid being in breach of its contract with the supplier if it has to go to an alternate source to meet an urgent demand for the product. Having the ability to go to another supplier in emergency situations may allow the buyer to avoid breaching its contractual commitment to deliver the product to the buyer's customer by a specific date.

The purchasing personnel on the buyer's end also need to make sure there is good internal communication regarding the obligation to purchase all or a specified percentage of the buyer's requirements from the supplier. We have heard of situations where this is not done and a buyer company commits to purchasing, for instance, 50 percent of its requirements from Supplier A, 40 percent from Supplier B, and 30 percent from Supplier C. Obviously, the buyer cannot fulfill its contractual obligations under all three contracts (i.e., it cannot buy 120 percent of its requirements for a product), so the buyer has set itself up to breach at least one, if not all three, of its requirements contracts. Proper internal communication within a purchasing department is the key to avoiding this kind of misstep.

It is also wise to clearly state in the contract that the buyer is committing to purchase all or a specified percentage of its requirements for the product from the supplier, but the buyer is not guaranteeing that it will have any demand for that product. The buyer should not represent that it will have a minimum level of demand when entering into a requirements contract, because circumstances can always change down the road.



## **Basic Blocking and Tackling for Requirements Contracts, *Continued from page 3***

Changes in the demand coming from the buyer's customers can put the buyer in a dangerous position if it commits to provide a minimum number of orders to the supplier, and the demand disappears (i.e., the buyer's primary customer might terminate its contract with the buyer) or never materializes (i.e., the buyer's customer overestimated its demand in order to get more favorable pricing from the buyer).

## **Fees & Burgess, P.C., Calendar of Events**

Fees & Burgess, P.C., is proud to present, or participate in the following upcoming events:

### **An Introduction to E-Verify for Alabama Employers**

**When:** February 8, 2012

**Where:** Fees & Burgess, P.C., and Webinar - Huntsville, Alabama

**Cost:** \$49

Under Alabama's new immigration law, the Beason-Hammon Alabama Taxpayer and Citizen Protection Act (HB 56), all employers in Alabama that have contracts with or receive grants or incentives from Alabama state, county, or city governments or agencies that are located in the state of Alabama will have to enroll in the federal government's E-Verify program no later than January 1, 2012.

All other employers in the state of Alabama will have to enroll in E-Verify no later than April 1, 2012.

Join us for a lunch and learn, either at our office or online, to discuss E-Verify, the federal and state requirements for using E-Verify, and the rules and responsibility for using E-Verify. The cost of this lunch and learn will be \$49.00, and will include lunch from the Honey Baked Ham Company for attendees, and \$49.00 for each remote listening site.

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### **Special Session: Contracting with the Customer: What the EMS Executive Needs to Know**

**When:** March 1, 2012

**Where:** San Diego, California

This industry-unique workshop presented by Jeff Roth and Allen Anderson, of Fees & Burgess, P.C., addresses the specific issues EMS companies face while contracting. Participants will be led through the contracting lifecycle between an electronic manufacturing services (EMS) provider and its customer, starting with the initial engagement and signing of a nondisclosure agreement, through the bid process and formal contract negotiation, to resolution of disputes under the applicable contract(s). In addition, discussions will include acknowledging customer purchase orders, methods of limiting financial risk, boilerplate warranties, ways to shed or limit product liability, and a checklist for determining and managing high-risk areas in EMS customer contracts. Through real EMS situations, attendees will develop an understanding of the contracting process and the questions that must be answered before entering into an agreement.

To register, or for more information about the 2012 IPC APEX Expo, please click [here](#).



**Fees & Burgess, P.C., Calendar of Events, *continued from page 4***

**Downsizing and Reductions in Force: Minimizing Risks and Defending Business Decisions**

**When:** March 13, 2012 11:30-12:45

**Where:** Fees & Burgess, P.C., - Huntsville, AL

**Cost:** \$49

It is never too late to prepare for and plan a strategy for reduction of risk in a downsizing environment. Even if your company has suffered significant reductions in force in the current economic downturn, start planning now to do it right the next time.

Join us for a lunch and learn, presented by Jeff Roth and Leah Green, to discuss downsizing and reductions in force, with a focus on:

- Proper downsizing decisions
- Employee selection
- Reviewing and defending decisions
- Areas of enhanced risk
- WARN Act requirements
- Pending legislation regarding employee entitlements
- Issues associated with reductions in hours worked
- Severance policies
- Releases
- Practical implementation

The cost for attendees will be \$49, including lunch from the Honey Baked Ham Company. Each attendee will also receive a matrix to assist in completing a WARN Act analysis and performing related calculations using the definitions provided in the statute.

For more information on these, and other future events, please visit us online at [www.feesburgess.com](http://www.feesburgess.com), or contact us at [seminars@feesburgess.com](mailto:seminars@feesburgess.com).





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**NEWSLETTERS**

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