Article

How To Draft Better Letters Of Intent For M&A Transactions

10.05.10

In private company M&A transactions, the document most often signed after a confidentiality agreement is a letter of intent (“LOI”). The main purpose of the LOI from the buyer’s standpoint is to get an exclusive look at the seller’s business for a specified period of time; the buyer doesn’t yet know enough about the business to bind itself to buy the business and wants sufficient time to conduct due diligence. But the buyer doesn’t want to sink a significant amount of time and resources into due diligence if the seller can simultaneously shop its business to other potential buyers. The seller, on the other hand, doesn’t want to allow buyer an exclusive look at the business unless the buyer sets the purchase price.

Here are some lessons I’ve learned that will hopefully help you draft LOIs that increase your odds of successfully closing M&A transactions:

- **Understand tax consequences at LOI stage.** Taxes typically have an enormous impact on deal economics, and many times buyers and sellers rush to get an LOI signed without fully considering the tax consequences. But adverse tax consequences to the buyer or seller can create trouble down the road and throw the deal in jeopardy. Therefore, I like to get all the major tax issues on the table before the LOI is signed so that the buyer and seller can understand the economic impact of taxes and factor it into the pricing. If you consider tax consequences early in the transaction, you may also be able to change the deal structure to allocate tax consequences between the parties to optimize the likelihood the deal will get done.
- **Specify buyer's key assumptions in the LOI.** After an LOI is signed and due diligence commences, the buyer often finds that it has made invalid assumptions about the seller's business. If this means that the purchase price should be adjusted, look out — that move will typically put the seller in a foul mood. For this reason, I like to see buyers put their key, high level pricing assumptions in the LOI. When the LOI contains the buyer’s key pricing assumptions, the buyer effectively gets a jump on its business due diligence efforts, and the seller can verify whether those assumptions are correct at the LOI stage, which may lessen the risk of price renegotiations.
- **Provide for termination of exclusivity period in limited circumstances.** In private company, non-bankruptcy M&A, the buyer doesn’t want to be a "stalking horse" — someone the seller uses to generate other higher offers from competing buyers — so the buyer almost always requires that the LOI specify an exclusivity, or “no shop”, period during which the seller agrees not to pursue alternative M&A transactions. This exclusivity period should give the buyer sufficient time to finish its due diligence and prepare definitive legal agreements that document the M&A transaction. But an exclusivity period may make the seller nervous since the LOI doesn’t bind the buyer to close the deal; the buyer can walk away and still require the seller to sit on the sidelines until the exclusivity period has expired. One approach I’ve found that can solve the seller’s concern is to provide in the LOI that the exclusivity period will terminate or be shortened if the buyer reduces the purchase price and the seller terminates the LOI for that reason.

Primary Contacts

Robert Kibby
Dallas
214.855.7504
rkibby@munsch.com

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