

LETTER OF INTENT —

The First Step in Buying or Selling a Business

By *Angela B. Martin, Esq.*

Do you have a client that is interested in selling their business? Or, perhaps you provide services to a client looking for an opportunity to purchase a business? If so, then you will likely encounter the Letter of Intent.

When a buyer and a seller come together to negotiate a merger or acquisition, they will often sign what is called a Letter of Intent. This Letter of Intent provides a written statement of the intent of the parties and documents in writing that they have reached an agreement on most of the terms of the transaction. These terms will generally form the basis for a separate, final contract and include a short description of the form of the transaction, the purchase price, when the transaction will occur, a confidentiality provision, a “no shop” provision, and other provisions which deal with the specific issues of the transaction. The parties' agreement will typically be subject to further due diligence or investigation and oftentimes the buyer's ability to obtain financing, all of which allows the document to be drafted in a way that allows for termination in the event that the parties, for whatever reason, decide not to go forward with the deal.

Advantages and Disadvantages

A Letter of Intent forces the parties to give thoughtful consideration to the terms of the proposed transaction and provides an initial point from which to begin negotiations. A Letter of Intent that clearly states the basic terms and key definitions of the proposed transaction serves to dispel ambiguity and confusion which, in turn, minimizes the possibility of the transaction later falling apart. Once signed, a Letter of Intent also gives the buyer a sense that the seller has undertaken a moral (though perhaps not a legal) obligation to consummate the transaction which places the buyer at ease prior to incurring significant out-of-pocket expenses for due diligence activities. Even so, caveat emptor. It is often a long and adventurous ride between signing the Letter of Intent and celebrating a successful deal in Fiji!

A Letter of Intent can also create potential issues. Once a Letter of Intent has been signed, it may not be possible to later renegotiate the substantive terms of the deal even though the Letter of Intent is supposedly non-binding. In addition, should the due diligence process take longer than anticipated, the seller is placed at a disadvantage since a well crafted no shop provision prevents the seller from conducting discussions with other potential purchasers or from soliciting competing offers. The buyer is also at risk since, without a so-called “breakup fee” written into the Letter of Intent, the buyer may have no recourse should the seller back out of the deal.

Is a Letter of Intent Needed?

Whether a Letter of Intent is necessary depends upon the specific facts and circumstances of the transaction. In instances where the parties are intimately acquainted with one another (e.g., family members or key employees), it may be possible to move directly to negotiating the transaction documents. In most circumstances it is advisable to have a Letter of Intent in place. In any event, it is of utmost importance to have your client's attorney review at the outset of negotiations whether a Letter of Intent is necessary and to advise you and your client as to the legal significance of a Letter of Intent that may already have been signed.

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