CHAPTER ONE
THE LETTER OF INTENT: RENEGOTIATION INSURANCE OR RECIPE FOR DISASTER?

After the buyer and seller have worked out the basic terms of their deal, a letter of intent serves to memorialize those terms in anticipation of the formal agreement. While generally intended to be non-binding, a letter of intent states the parties’ intention to enter into a transaction and recites the basic business points (e.g., purchase price, timetable, form of consideration), thereby helping to move the deal along. Unfortunately, too often parties enter into letters of intent without a great deal of thought. Indeed, in some radio transactions, the letter of intent — also referred to as a “memorandum of understanding” or “agreement in principle” — is drafted by the broker using a fill-in-the-blanks boilerplate letter. By contrast, in other situations, the letter of intent is drafted — and redrafted — by multiple lawyers and can become the subject of seemingly endless negotiations between the parties. One of the benefits of a well-drafted and negotiated letter of intent is that it makes the negotiation of the definitive agreement speedier and easier.

Inattention to the consequences of a letter of intent can be very costly. In one dramatic case for example — the proposed acquisition of Getty Oil by Pennzoil — the letter of intent formed the basis of a jury award of $11.2 billion. Now that we have your attention, we will give you some suggestions on the do’s and don’ts of letters of intent.

The Letter of Intent: To Write or Not to Write

Let’s assume that you and a prospective buyer have arrived at a price for the sale of a radio station, or have at least determined a formula for setting the price. Should you be content with just a “handshake deal” until a definitive agreement is executed at some later date?

Ask a lawyer any question and you invariably get the same answer: “It depends.” There is no absolute rule as to whether or not there should be a letter of intent in each transaction — it depends on the facts involved. Certain factors may lead to a decision to put an agreement in principle in writing. One reason may be that the parties will feel bound to a greater degree if the agreement is evidenced by a signed document than if it is not. Also, the longer the parties wait to place their oral understanding in writing, the greater the chance for misunderstanding. This is especially true when the terms of the deal are relatively complicated and a written letter will serve to assure that there has been no miscommunication on the essential terms of the transaction. Another good reason for a letter of intent is to convince a third party (such as a bank, where financing is required) that the transaction is viable. Also, another benefit of a letter of intent is that it keeps the seller from using the buyer as a stalking horse to negotiate a deal with a third party.

One legal scholar has commented, in only slightly irreverent terms, that a letter of intent is a form of “anti-renegotiation insurance.” Such letters represent an explicit moral obligation of the parties, which reasonably principled business executives seem to take quite seriously. Also, a letter of intent can provide a structure for the transaction from which the definitive agreement can be drafted and might allow the parties to make announcements to customers, suppliers, and employees, which is often desirable. From a buyer’s perspective, a letter of intent containing a “no shop” clause provides a definite period of time in which the seller is prohibited from marketing the station to other parties. This provision usually has the effect of making the seller take the letter of intent more seriously and encourages both parties and their lawyers to complete the definitive agreement before the “no shop” deadline expires.
The well constructed letter of intent serves four main purposes. First, it sets forth the details and structure of the transaction, thus saving time for the buyer and the seller in briefing and rebriefing their respective lawyers as to what was intended. Second, it helps to keep the parties and the lawyers from renegotiating the essential terms of the deal. Third, it helps to insure that the seller stops marketing or entertaining offers while the definitive agreement is being drafted. Fourth, the deadline in the “no-shop” provision helps to keep both sides focused on getting the deal done. Where a letter of intent is entered into by the parties, we would counsel against a public announcement or notification of the proposed sale to vendors and employees. There is too much risk of personnel distraction or loss due to the time lag between signing the letter of intent and the definitive agreement during which time it is very difficult to assure the seller’s employees as to the new owner’s intentions. There is also the potential embarrassment for both parties if the announced deal does not materialize.

However, a letter of intent presents some disadvantages. In some situations, especially deals involving small amounts of money, it may be preferable to move ahead directly to the ultimate agreement rather than waste time, money and energy in negotiating a detailed letter of intent. Often the key factor is the length of time expected to elapse between the letter of intent and completion of the definitive agreement. The shorter the period, the less desirable it is to enter into a letter of intent. Also, the parties may not be ready to sign a letter of intent because an agreement has not been reached on important details, or one or both of the parties is not ready to issue a public announcement. Of course, to a seller that is quietly negotiating with more than one party, the signing of a letter of intent is not desirable until those negotiations are complete.

Prior to obtaining a letter of intent or if there is no letter of intent, we recommend that the seller ask the buyer to sign a confidentiality agreement. Appendix A contains a sample confidentiality agreement.

**Points to be Covered**

Typically, a letter of intent takes the form of a letter addressed to the seller, signed by the buyer, and then countersigned and dated by the seller or, in the case of a sale of stock, by the selling shareholders. When there are large numbers of shareholders, it is desirable to have the letter of intent countersigned by the principal shareholders. If any trouble is anticipated from minority shareholders, the buyer would be well advised to obtain their signatures as well.

Although letters of intent vary, the following checklist identifies several points that might be covered:

- a statement of the nature of the transaction (*e.g.*, acquisition of stock, purchase of assets, merger, etc.)

- in the case of an asset deal, a description of (a) the assets being acquired (*e.g.*, whether or not the accounts receivable are being purchased, whether the assets are being acquired free of liens and encumbrances and with or without the assumption of liabilities) and (b) the excluded assets; or, in the case of a stock deal, a description of the stock to be purchased

- a description of the purchase price or the formula for determining the purchase price

- the payment terms (*i.e.*, the consideration to be paid or exchanged at the closing and, if applicable, the amount and timing of any deferred payments)

- if deferred payments are involved, the type of any security to be provided to the seller (*e.g.*, security agreement, personal and/or corporate guarantees, stock pledges, etc.)
☐ any special arrangements the buyer will require relative to any of the seller’s officers, directors or employees (e.g., covenants not to compete, consulting agreements, stock options, employment agreements, etc.)

☐ responsibility for the drafting of the purchase and sale agreement (normally it is the buyer’s counsel who drafts the agreement)

☐ a statement of conditions precedent to consummation of the transaction (e.g., subject to the prior approval of the Federal Communications Commission, and where a filing is required under the Hart-Scott-Rodino Improvements Act of 1976, the Department of Justice and the Federal Trade Commission; approval by the Board of Directors and in some cases, the shareholders of the parties; the execution of a definitive asset or stock purchase agreement; no material adverse change between execution of the definitive agreement and the closing; a financing contingency, etc.)

☐ any necessary disclaimers (the letter of intent should clearly state whether or not it is intended to constitute a binding agreement — a topic discussed later in this chapter)

☐ escrow arrangements (e.g., provision for placement of funds in escrow upon the execution of the letter of intent and/or the definitive agreement; whether the escrow will be the agreed-upon amount of liquidated damages whether there will be a post-closing indemnification escrow)

☐ responsibility for payment of brokerage or finder’s fees, recording fees, transfer taxes and other transactional costs

☐ maintenance of the confidentiality of information

☐ public announcements (e.g., no party will issue any public announcement concerning the transaction without the approval of the other party)

☐ the deadline (if any) for the execution of a definitive agreement and/or the period of exclusive dealing (i.e., the length of time the seller is obligated to refrain from soliciting, encouraging or considering other offers for the sale of the assets or stock)

Many letters of intent generally state that the definitive agreement will contain such representations, warranties, covenants and indemnification provisions as are customary and appropriate to transactions of similar size and nature. Some letters include specific representations and warranties about such matters as the condition of equipment and compliance with FCC rules. Other letters deal with such subjects as the allocation of the purchase price for tax and accounting purposes, responsibility for payment of fees, expenses and taxes, covenants concerning the conduct of business before the closing, and the need for a “final order” issued by the FCC consenting to the sale. The more points covered, the more a letter of intent begins to look like a blueprint for a formal agreement. Such a comprehensive letter of intent could save time or could serve as a red flag to all parties if it appears that fundamental issues cannot be resolved — a clear signal that more time will be needed to reach a definitive agreement.

Appendix A contains examples of four different forms of letters of intent. These letters should be regarded as a starting point to be tailored to meet your individual objectives and concerns. There is no such thing as a standard letter of intent applicable to all proposed transactions.
To Bind or Not to Bind

Lawyers burned by letters of intent have characterized the document as “an invention of the devil” to be avoided at all costs. This hostility stems from one of the principal problems with letters of intent: the unpredictability of their enforceability in litigation.

Predicting the enforceability of letters of intent has baffled sophisticated business executives and legal experts alike. Generally speaking, most business executives assume that a letter of intent is simply an unenforceable “agreement to agree.” Probably the most famous, and most costly, expression of this point of view was made in the midst of the battle between Texaco and Pennzoil for the Getty Oil Company. There, the Chairman of Getty Oil, Sidney Peterson, responded to a question from the Chairman of Texaco, John McKinley, concerning whether Getty was still available notwithstanding an “agreement in principle” that Getty had signed with Pennzoil. Peterson’s response — “the fat lady had not yet sung” — has become a permanent fixture of American corporate folklore. Texaco later disclosed to the Securities and Exchange Commission that its “liability from the [Pennzoil] suit [was] not expected to be materially important.” An $11.2 billion error in judgment by experienced corporate executives and high-priced Wall Street lawyers is a sobering reminder to anyone who contemplates entering into a letter of intent but wants to leave some wriggle room. Apparently the “fat lady” sings softly at times.

The reported cases are not particularly reassuring to a party who does not wish to be bound by a letter of intent. Judicial decisions analyzing the enforceability of letters of intent have come down all over the board. The reason for this is twofold. First, whether a letter of intent is binding is a factual question, not a legal issue. Second, some courts have decided to imply from the letter of intent a duty to negotiate in good faith. Anyone considering a letter of intent should be familiar with both of these issues.

The factual issue in letter of intent litigation focuses on whether the parties intended to be bound before the execution of a definitive purchase agreement. The factual rather than legal nature of this question carries some very practical consequences. First, factual questions are to be decided by the trier of fact. This means that summary judgment may not be available to the station owner who decided to accept a higher offer after entering into a letter of intent because the material question of the parties’ intent remains in dispute and can be decided by the judge or jury only after an often long and expensive trial. Because this issue is factual rather than legal, “forum shopping” (i.e., choosing a state whose law is thought to be more favorable) may not always guarantee a favorable result. The jury or the judge (in the event of a bench trial) looks at all of the facts concerning a particular case to determine what the parties intended. Since the facts in any two cases are rarely, if ever, identical, the jury or the judge has wide latitude in reaching a decision.

Even more troublesome is the application in letter of intent cases of a duty to negotiate in good faith. For example, in Itek Corporation v. Chicago Aerial Industries, 248 A.2d 625 (Del. 1968), the parties entered into a letter of intent that expressly stated that they would be under no further obligation to each other if they failed to agree upon and execute a definitive sales contract. The seller attempted to back out of the letter of intent when a second suitor came along with a better offer. Notwithstanding the clear language of the letter of intent, the court imposed on the seller a duty to negotiate in good faith. The practical result is that the seller had the burden of demonstrating that it acted in good faith when it did not follow through on the letter of intent.

A Recipe for a Practical Approach

An all too familiar scenario involves a buyer and seller who have a “handshake” deal and, in their eagerness to memorialize their understanding, rush through the drafting of a letter of intent. Both parties are relaxed about the wording of such a letter of intent because they believe it is non-binding and they save their energies for the drafting of a definitive agreement.
We suggest that you think twice before deciding on the next step following a handshake. Decide whether and to what extent you want to sign a letter of intent which is binding. You need to be aware that a court may decide that a letter of intent is binding even though one or both parties do not so intend. Make sure that your intent, for example, not to be bound, is made explicitly clear in the letter of intent. Also, be aware that a letter of intent may give rise to implied covenants such as a covenant to negotiate in good faith even where the intent not to be bound is clear. (Some buyers include a provision in the letter of intent specifically obligating the seller to negotiate during the “no shop” period.) A fundamental issue is whether a letter of intent is necessary or appropriate for the particular transaction or whether proceeding directly with the drafting of a definitive agreement provides a more practical course.

If you decide on entering into a letter of intent, draft the document carefully with a full appreciation of all of the pitfalls that can result. If your goal is to preserve some “wiggle room,” but the circumstances seem to justify a letter of intent, then the following steps should be taken.

First, the letter of intent should contain a clear and unequivocal statement that the parties do not intend to be bound until a definitive contract is executed. All subsequent communications should uniformly be consistent with this approach. Most of the litigation concerning the enforceability of letters of intent arises from letters that do not clearly reflect the intent of the parties on enforceability. Two of the illustrative letters of intent in Appendix B explicitly identify the terms that are binding (e.g., confidentiality, no-shop, access, publicity, etc.) and those that are not (e.g., the purchase price, the amount of the escrow, excluded assets, etc.).

Second, the letter of intent should set forth the basic terms of the deal without great specificity — leave open some real substantive issues for the final negotiations.

Third, if your lawyer cannot assure you that your letter of intent will be unenforceable, consider adding a modest liquidated damages provision. While this would, practically speaking, result in a determination that the letter of intent was binding, it could serve as a basis for limiting your liability. Obviously, if you want the letter of intent to be binding, insist on the insertion of a liquidated damages provision with a healthy but realistic amount of damages.

A letter of intent should never be entered into casually. Since we know that the fat lady is capable of singing softly, listen very carefully before entering into a letter of intent.