

# Top 10 Tips for Drafting a Letter of Intent for Successful M&A Negotiations

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Engaging mergers and acquisition (M&A) counsel early in the process, prior to entering into a letter of intent (LOI), is critical to address key issues and to avoid losing leverage in the negotiation process. Contentious issues routinely arise in transactions. Identifying those issues and addressing them at an early stage can avoid the waste of critical resources and lead to a smoother transaction or can signal that a transaction is not feasible. Here are ten (10) key issues worth considering in negotiating a letter of intent.

## 1. Be Specific.

LOIs are often written in very general terms with many material terms left to be resolved during the diligence and drafting of definitive agreements phases of the process. This can be particularly troublesome for sellers as sellers lose critical leverage in the negotiation process once the LOI has been signed. M&A transactions are complex, time consuming and expensive. Tackling the critical issues and addressing them at an early stage may avoid later disputes and can preserve valuable resources – even if that means that a transaction does not move forward.

## 2. Purchase Price.

The value of a business is a critical component to any M&A transaction. Making sure the parties are clear on the purchase price assures that there is no room for debate during the negotiation phase. It is best to avoid ranges of value and to have the discussions up front to set expectations.

## 3. Contingent Consideration.

The use of contingent consideration (i.e., earn-outs) is prevalent in M&A transactions and can represent a significant amount of the deal consideration. The milestones set for achieving earn-outs and the safeguards sellers request to protect the ability to achieve earn-outs (i.e. control elements) can be quite complex. The LOI should be as specific as possible with respect to milestones and seller protections.

## 4. Structure of the Transaction.

The structure of the transaction (stock purchase, asset purchase, merger) can be important to the parties. The tax impact to the parties may vary based on the structure proposed. At a minimum, the LOI should indicate that the parties agree to use the most tax efficient structure and should provide flexibility to the parties to achieve the desired result.

## 5. Indemnification.

In many cases, an LOI will use generic language regarding customary indemnification provisions. A well-crafted LOI should address issues such as fundamental representations and warranties, survival periods, baskets/deductibles and caps on liability. A Buyer may balk at

agreeing to specific indemnity language at such an early stage, but by including qualifying language such as subject to confirmatory due diligence, there is no reason why specific terms may not be included. As noted above, this is particularly important for sellers due to the loss of negotiation leverage once the LOI has been signed.

## 6. Employment Agreements.

Buyers often require that certain key employees of the target enter into employment agreements in connection with transactions. The LOI should identify the key employees and, if possible, should outline the key terms of employment (compensation, benefits, term, severance and restrictive covenants) in the LOI.

## 7. Restrictive Covenants.

The LOI should address post-closing restrictive covenants including the duration, scope (definition of business and geographic) and name the sellers bound by the non-compete (institutional investors and smaller stockholders receiving less consideration may not be bound by the non-competition restrictions or may be subject to a shorter duration).

## 8. No Shop; Exclusivity.

Buyer will want to restrict the sellers from shopping the business to another party for a certain period of time following execution of the LOI. The time period allows for the conduct of due diligence and the drafting and negotiation of definitive documentation. The LOI should address both the duration of the exclusivity period and activities that are not permitted with the goal of requiring the parties to move expeditiously.

## 9. Purchase Price Adjustment.

To the extent the Buyer requires a purchase price adjustment, the terms should be described in the LOI. This includes target working capital, adjustment escrow, if any, a collar and a sample calculation.

## 10. Rep and Warranty Insurance.

Representation and Warranty insurance has become a more common feature in M&A transactions. To the extent the parties agree to pursue representation and warranty insurance, the LOI should specify the level of effort to obtain the insurance, the retention amount and allocation of the premium costs.

If you have questions about a letter of intent related to an M&A transaction, please contact [Joe Marrow](#) or visit our [M&A Practice Area](#) page.