7 Deadly Sins of Pre-Deal Documents
(LOI, MOU and Term Sheets)
OR

Enforceable Unenforceability.

By

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And

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Introduction.

Admittedly, the classic Seven Deadly Sins[3] do not ordinarily impact the rules of contract drafting. However, the dramatic title is appropriate since this article will focus on seven issues that can arise when negotiating and drafting Pre-Deal Documents. The humble LOI or MOU can seem almost innocuous – nothing more than a list of issues to be considered while drafting the final agreements for the transaction. But that simple LOI could lay waste to a carefully planned transaction. The fallout from improperly drafted (and typically neglected) pre-deal documents, can determine the enforceability of terms you never expected to be enforced, the value to be received, and the remedies available to the parties.

How long/sophisticated is the typical Pre-Deal Document?

> The age-old question is: How long is a piece of string?
>
> And the age-old answer is: It depends on the string.

Likewise, there is no "one-size-fits-all" for an LOI. Unless you have a repetitive transaction (sales of goods, franchising, etc.) each deal is unique, and each LOI is unique. So, no one LOI or MOU will apply

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[3] Wrath, greed, sloth, pride, lust, envy, and gluttony.

to every transaction. Certainly, some basics generally apply, but each LOI depends upon the facts, parties, and counsel in each transaction.

In the time and space allotted for this article and presentation, complete coverage of the potential pitfalls lurking in every term of every type of Pre-Deal Document is not practical. However, the key principle in dealing with drafting an LOI can be easily stated:

Sculpt the provisions of an LOI as carefully as you would the payment terms.

Or

Understand the risk in failing to do so.

What are Pre-Deal Documents?

Term Sheet: Generally formatted as an abbreviated list of key points. Commonly used in the banking industry to layout the terms of a potential loan. Typically, the Term Sheet has NO enforceable provisions. Banks typically make it clear that the Term Sheet does not obligate the bank to make the loan.

Letter Of Intent ("LOI"). Generally prepared in letter format and usually includes more detail on key terms than a term sheet. The LOI will typically have some enforceable provisions (Exclusivity, Confidentiality (if there is no NDA), expenses, access to due diligence, etc.), but specifically states the list of terms to be negotiated are not enforceable. Most often used by US-based parties in M&A transactions.

Memorandum of Understanding. ("MOU") Generally more comprehensive than both term sheets and letters of intent. In most instances, every term in an MOU will be fully enforceable – thus the name "Memorandum of Understanding" – implies that the parties have reached an agreement. Commonly used by non-US parties.

The Seven Deadly Sins of Pre-Deal Documents:

Sin #1 - Sin of Over/Under/Improper Use.

Sin #2 - Sin of Strategic Failure.

Sin #3 – Sin of Generalization.

Sin #4 – Sin of Over-Completeness

Sin #5 – Sin of Unavoided Enforceability

Sin #6 - Sin of Waiving That Which Cannot be Waived.

Sin #7 – Sin of Inconsistent Documentation

Sin#1 – Sin of Over/Under/Improper Use

Why use an LOI if it is non-binding?

- **Tests Commitment Level:** The LOI tests the parties' seriousness and commitment before they invest time and energy in the transaction.
- **Morally Commits:** The LOI morally commits each party and is a test of good faith.
- **Expresses Intentions:** The LOI expresses the parties' intentions and is helpful in discovering a party's true intentions and priorities.
- **Clarifies Key Terms:** The LOI memorializes the key terms.
- **Grants Exclusivity:** The LOI can grant exclusivity to the buyer so they can spend money on conducting due diligence.
- **Reduces Uncertainty:** The LOI reduces the likelihood that the parties will disagree on the terms of a transaction in later stages of the negotiations.
- **Clearly Defines Contingencies:** The LOI clearly defines the conditions or contingencies.
- **Enables Financing Pre-Approval:** The LOI is required by many lenders before they underwrite a loan.
- **Grants Permissions:** The LOI allows the parties to conduct due diligence before they commit to the expense of preparing and negotiating a purchase agreement.
- **Agree on Price:** The LOI allows the parties to agree on a price (and approved pricing adjustments) before committing to the expense of performing due diligence.

When to use an LOI:

Especially useful where there are some KEY complex terms that MUST be worked out up front, or there is no deal.

- Post-Closing adjustment to purchase price
- Earn out payments
- Complex pricing formulae
- Which employees must remain
- Terms of Seller's Non-competition
- Does a counterparty have a history of being a jerk?
- Clarity on what data will be made available for Due Diligence and when

When not to use an LOI:

- Parties REALLY DO (no kidding) agree on the terms.
- The Parties have done transactions before, and no surprises are anticipated – really.
- Transaction is not big enough to justify the additional expense of an LOI.
- Time frame is too short to justify an LOI

Sin #2 – Sin of Strategic Failure

What Strategies should be considered as the LOI is negotiated and/or drafted?

- **Balance of Power:** Take your time to ensure the LOI is as specific as possible. The less precise the LOI, the more opportunities the buyer will have to renegotiate the terms later in the transaction. Once the Seller signs an LOI, especially an LOI with an exclusivity provision, the Buyer has almost nothing to lose, and the Seller has a LOT to lose. If the Buyer backs out, the

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