HOLMBERG | WATSON
BUSINESS & ESTATE LAWYERS

BUSINESS LAW FEBRUARY 2016

THE LETTER OF INTENT – THERE IS MORE TO IT THAN THE PRICE!

The sale of a business typically begins with a buyer and seller, either directly, or through agents or lawyers, having a discussion in general terms about what is being purchased and how much will be paid. Typically, if there is a desire to move forward, these general terms are set out in a form of letter called a *letter of intent* (LOI) that is drafted by the buyer (or his agent or lawyer) and proposes that if the seller is in agreement with the stated general terms, a due diligence process will begin that may culminate in the execution of a comprehensive agreement of purchase and sale (APS). LOIs are usually drafted so that neither the buyer nor the seller is bound to complete the deal unless an APS is signed.

At the very least, the LOI will set out what the purchase price will be or how it will be calculated. But there are many other important terms that should be addressed in the LOI. If the seller agrees to the purchase price in the LOI but other important terms are not dealt with because they "*can be negotiated later*" in the APS, the seller will have given up a major tactical advantage.

That is because, for the most part, these other terms that will be included in the APS will benefit the buyer or protect its interests, more than the seller. If the purchase price is settled in the LOI, the seller has less opportunity to use the purchase price as a bargaining chip to achieve terms most favourable to it. As long as the purchase price is not settled, the seller can require the buyer to pay more if the buyer wants these other terms to be more favourable.

This reduction of the seller's bargaining power is increased by the common "*no shop*" or "*exclusivity*" provision. LOIs usually include a provision that prevents the seller from even discussing the sale of the business with any third party while the buyer and seller are still expecting to negotiate and execute an APS.

So what other terms should be included in the LOI?

- For a start, the LOI should name the parties, the business and exactly what is being sold. Will it be sale of the shares of the corporation that owns the assets, or a sale by the corporation of all its assets and its business as a going concern?
- Then, the purchase price, and how it will be paid should be stated. Will it be fully paid on closing, or is the buyer expecting the seller to finance part of the purchase by accepting a promissory note in payment?
- Another very important term is whether there will be will be an adjustment to the purchase price based on the amount of working capital in the business at the time of closing. If there is to

be an adjustment, what is the formula for the adjustment, how will the parties resolve any dispute over the adjustment calculation, and will any part of the purchase price be withheld following closing pending determination of the adjustment?

- The buyer typically will require the seller to represent and warrant to the buyer certain facts about the business being sold. This is usually coupled with an obligation on the seller to indemnify the buyer if these representations are not true, and to indemnify the buyer if a party with a claim against the seller asserts this claim against the buyer (other than for liabilities that the seller agrees to assume).
- These indemnification provisions typically include provisions regarding how long after closing the buyer can assert a claim against the seller, a threshold in the amount of claims below which the buyer cannot assert a claim, caps on the amount of claims the buyer can assert, and whether there will be a hold back of part of the purchase price as security for paying the buyer's claims.
- The buyer will want the seller to promise to restrict its business activities to ensure that it will not start up again and compete. What will these restrictions include? The seller may insist upon non-solicitation of customers, non-solicitation of employees, and extensive non-compete, provisions. How long will those provisions last?
- Will the buyer insist on the seller agreeing to stay on as an employee for a period after closing?

Conclusion. Instead of being only a quick first step in a sale of business transaction, business sellers should treat the Letter of Intent as the main event. This will benefit both parties significantly in terms of time and expense and, particularly for the seller, in terms of bargaining power.

Need advice? If you need help contact Mihkel Holmberg or Kate Watson for expert legal advice concerning your business.

Our Lawyers

Mihkel Holmberg
mihkel@holmbergwatson.ca
416.648.8499

Kate Watson
kate@holmbergwatson.ca
647.500.0844

Peter Math
peter@holmbergwatson.ca
416.274.4752

Lorne Gross
lorne@holmbergwatson.ca
416.453.6596