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Structuring MOUs, LOIs, Term Sheets, and Other Nonbinding Legal Documents

Avoiding Unintended Performance or Financial Obligations, Utilizing Express Disclaimer Language, and Limiting Drafting Ambiguity

THURSDAY, APRIL 23, 2020

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

May Lu, Shareholder, **Tiffany & Bosco**, Phoenix

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Structuring MOUs, LOIs, Term Sheets and Other Nonbinding Legal Documents:

Avoiding Unintended Performance or Financial Obligations, Utilizing
Express Disclaimer Language, and Limiting Drafting Ambiguity

April 23, 2020

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Background

ALTERNATIVES:

- Contract – *Binding agreement*
- Expression of Intent (“EOI”) – Non-binding writing to reflect genuine interest
- Letter of Intent (“LOI”)/Memorandum of Understanding (“MOU”)/Term Sheet – Hybrid

Letter of Intent

An LOI is a HYBRID of a Contract and an Expression of Intent.

- NOT a Comprehensive Agreement
- Some Terms are Binding
- Subject to Limited Enforcement
- May be incorporated or merged into Final Comprehensive Agreement
- Terms of an LOI tend to control its impact



Enforceability

- **Contract** – Enforceable at law

- **Expression Of Intent**

Generally unenforceable, BUT:

Detrimental Reliance Risk

Misrepresentation/Fraud Risk

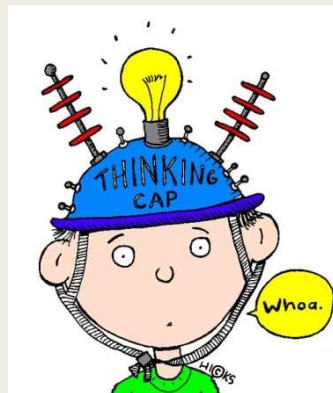
- **Letter of Intent**

Precisely Drafted: Per its terms

Inartfully Drafted: Risks Unintended Results

Contract Elements

- Was there an **Offer**?
- Was the Offer **Accepted**?
- Was **Mutual Consideration** Promised?
- **Time** Certain Set or Reasonable Time Implied?
- Does there appear to be a **Meeting of the Minds**?



Evaluating a Writing

- All Elements Present = Contract
 - All Elements Missing = Expression of Intent
 - Some Elements Present = Needs Definition
- Confirm its a Letter of Intent?
- Turn it into a refined Contract?
- Cool it down to just an Expression of Intent?

Use of LOI – Part 1

- Goals:

- Confirm Deal Terms

- Allow non-attorneys to negotiate

- Limit Attorney Involvement to Contract

- Compliance with Custom

- Advantages:

- Speed

- Focus on Desiderata

- Cost Savings

- Disadvantages:

- Too Little/Too Much Authority

- Too Much/Too Little Negotiated

- Duplication of Effort

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Use of LOI – Part 2

- Risks:
 - Locked-In or Unlocked Terms
 - Omitted Considerations
 - Operational Reliance v. Lack of Readiness
- Costs/benefits:
 - Not Uniform
 - Quantification Difficulty
 - Counterpart Evaluation
 - Management Decision



Preliminary Writings Can be Binding

- An LOI, though still considered a preliminary writing by one or all parties, may be judicially construed to form and constitute a binding contract.
- Second Circuit has developed a framework for analyzing types of preliminary contracts that are considered to have binding force. See *Adjustrite Sys., Inc. v. GAB Bus. Servs., Inc.*, 145 F.3d 543 (2d Cir. 1998).
- This framework has been followed by other jurisdictions, including Delaware. See, e.g., *Siga Techs., Inc. v. PharmaAthene, Inc.*, 67 A.3d 330 (Del. 2013).

Preliminary Contract Types

- Type I Agreement = fully binding preliminary agreement
- Type II Agreement = binding preliminary commitment



Type I Agreement



- No **disputed issues** are perceived to remain
- A **further contract** is envisioned primarily to satisfy **formalities**
- Is fully created when the parties **agree on all the points** that require negotiation (including whether to be bound) but agree to memorialize their agreement in a **more formal document**
- **Both parties are fully bound**, even if the subsequent, more formal “long form” agreement is not executed
- Are communications conditions precedent for creating an agreement? See, e.g., *Kortright Capital Partners LP v. Investcorp Inv. Advisers Ltd.*, 327 F. Supp. 3d 673, 680-683 (S.D.N.Y. 2018).

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Type I Agreement

- Four factors:
 1. Is there an express reservation of right not to be bound in the absence of writing?
 2. Has there been partial performance?
 3. Have all terms of alleged contract been agreed upon?
 4. Is agreement at issue type of contract usually committed to writing?
- The first is most important.
- See *Adjustrite*, 145 F.3d at 549.
 - Court held that there was no binding Type I Agreement



Type I Agreement

- Does language of the document disclose an “**intention** by the parties **to be bound** to the ultimate objective,” and “is frequently determined by **explicit language** of commitment or reservation”?
 - See *Brown v. Cara*, 420 F.3d 148, 154 (2d Cir. 2005) (the MOU did not bind the parties to complete the project but did bind them to negotiate open terms in good faith regarding developing the property so not a binding Type I Agreement but was a binding Type II Agreement).
- If the language of the agreement is clear that the parties **did not intend to be bound**, “the Court need look no further.” See *Cohen v. Lehman Bros. Bank, FSB*, 273 F. Supp. 2d 524, 528 (S.D.N.Y. 2003).

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Type II Agreement



- Commitments **binding only to certain degree**
 - Parties agree on certain major terms
 - Leave other terms open for further negotiation
- Parties recognize existence of open terms, even major ones, but, having agreed on certain important terms, agree to **bind themselves to negotiate in good faith** to work out the open terms
- Does **not commit** parties to their **ultimate contractual objective** but only to **negotiate open issues in good faith** within an agreed framework
- Does not guarantee that final contract will be concluded

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Type II Agreement



- Courts must weigh **five** factors:
 1. **Language** of the agreement;
 2. **Context** of negotiations;
 3. Existence of **open terms**;
 4. **Partial performance**; and
 5. Necessity of **putting agreement in final form**, as indicated by the customary form of such transactions

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Type II Agreement

- Factors are similar to Type I, but have a different significance:
 - For 1st factor, language need only evidence an intention to be bound to the document as a general framework in which the parties will proceed in good faith toward the contractual goal
 - Existence of open terms, calls for future approval, and express anticipation of future preparation and execution of contract documents create a presumption against finding a binding contract, but same omissions may support finding a binding Type II agreement

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Type II Agreement

- *Teachers Ins. & Annuity Ass'n of Am. v. Tribune Co.*, 670 F. Supp. 491, 498 (S.D.N.Y. 1987).
 - Institutional lender sued prospective borrower for breach of commitment letter agreement for \$76M loan
 - Court found that the letter agreement was a Type II Agreement and that the prospective borrower breached the requirement to negotiate in good faith
 - A party is barred from “renouncing the deal, abandoning the negotiations, or insisting on conditions that do not conform to the preliminary agreement.”

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Type II Agreement

- See *Arcadian Phosphates, Inc. v. Arcadian Corp.*, 884 F.2d 69, 72 (2d Cir. 1989).
 - “Preliminary manifestation of intent” because reference to possibility that negotiations might fail and that a binding agreement be completed at future date
 - Court found Type II Agreement so not an enforceable agreement to buy/sell



Why Bother?

- “Courtship Courtesies” - Failing to clearly address tough issues early in the process
- Establish reasonable expectations about:
 - Negotiating leverage
 - Closing timetable
 - Other matters
- LOI may be the only agreement the parties sign



Creating the LOI

Binding versus non-binding provisions



Substantive Provisions



- Purchase price
- Payment terms
- Assets or ownership interests being purchased
- Employment matters
- Conditions for Closing
- Unusual representations and warranties

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Substantive Provisions

- Due diligence and access to records
- Conduct of business
- No liability
- Legal intent of the parties



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Substantive Provisions

- Scope of Confidentiality – Trade Secrets
 - UTSA:
<https://www.uniformlaws.org/committees/community-home?communitykey=3a2538fb-e030-4e2d-a9e2-90373dc05792&tab=groupdetails>
 - Defend Trade Secrets Act of 2016: See 18 U.S.C. 1831 et seq.
- Separate agreements



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Substantive Provisions

Exclusive v. Non-Exclusive

No shop clauses

[Reconsider: Detrimental
Reliance]

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Substantive Provisions

- Regulatory recognition
 - Export prohibitions
 - Duly Licensed
 - Tax Responsibilities
 - Sales
 - Withholding
 - Other



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Procedural Provisions

Timing

Deadlines

Termination

Surviving
terms

Break up
fees

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Procedural Provisions

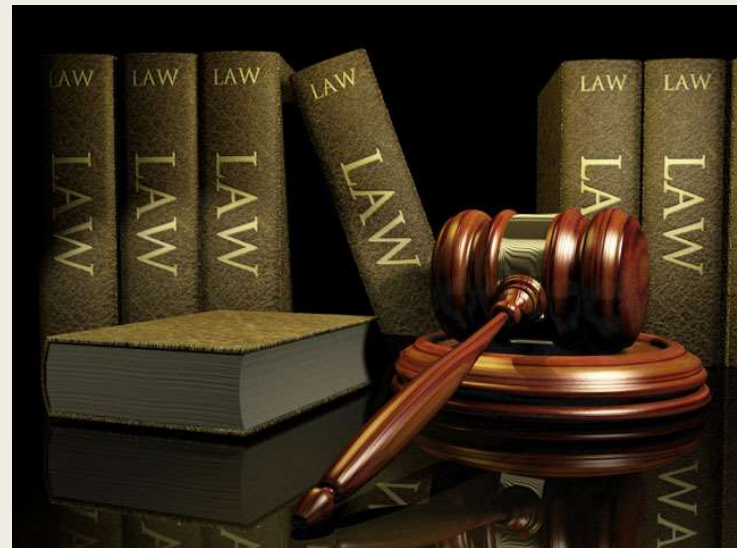
- Express duty to act in good faith
 - NY: duty to negotiate in good faith must be express
 - DE: parties' intentions control whether an LOI creates obligation to negotiate in good faith, despite whether material terms remain open
- Implied covenant of good faith/fair dealing
 - Breach must be motivated by improper purpose reflecting bad faith
 - May not prohibit acts expressly permitted by contract

Procedural Provisions

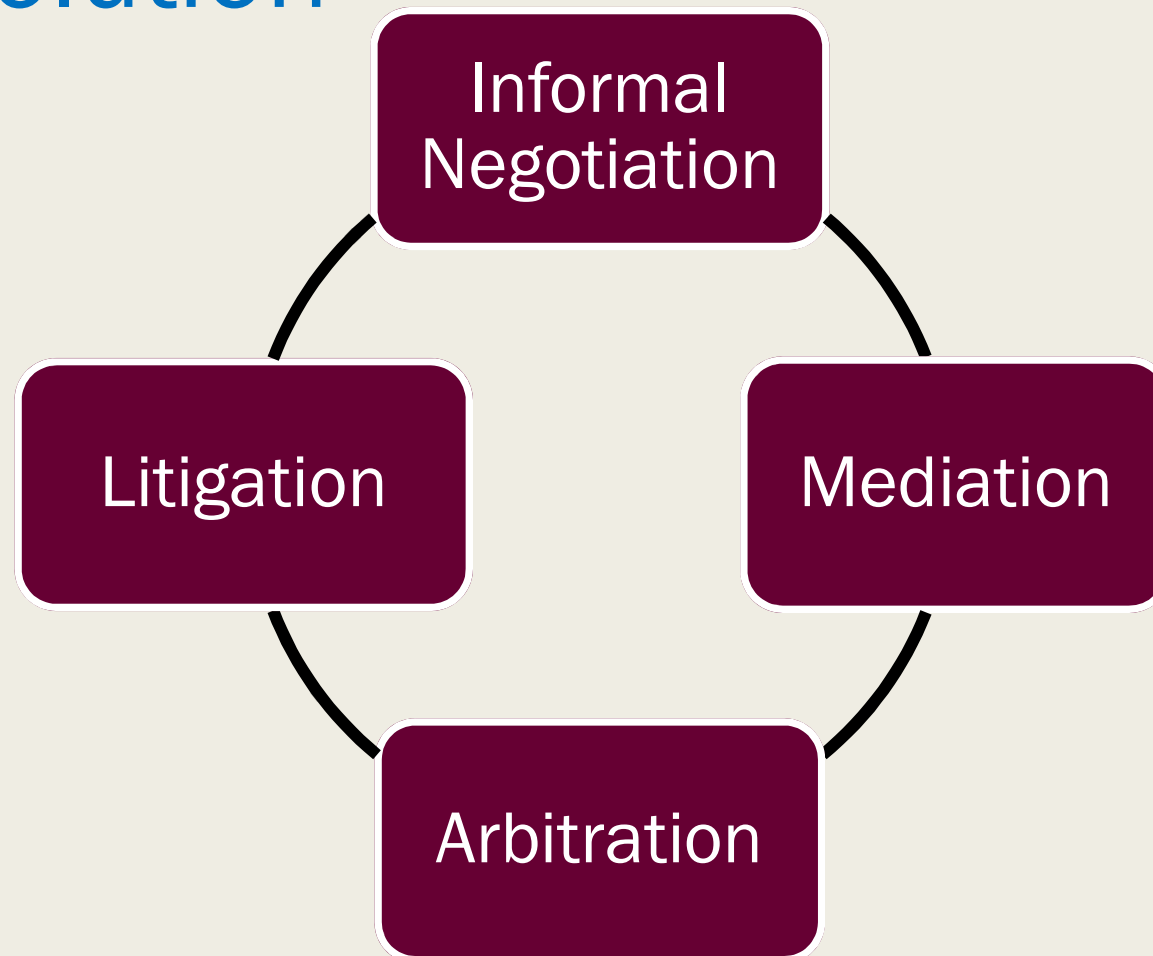
- Expenses
 - Attorneys' fees
 - Brokers
 - Appraisal costs
 - Lien and judgment searches fees
 - Other Initial Due Diligence Costs

Procedural Provisions

- Cooperation Duty
- Notice
- Force Majeure
 - Pandemics
- Choice of Law
- Venue



Avoiding Liability – Dispute Resolution



Avoiding Liability

- Strategies for avoiding litigation when structuring preliminary provisions
 - Cover Sheet Terms
 - Automatic Termination Deadline
 - Adequate Notice & Cures
 - Liquidated Damages
- Avoid unintentionally binding agreements in email/telex/etc. exchanges
 - See, e.g., *Lopes v. Webster Bank, N.A.*, No. 3:16-CV-1627 (JCH), 2018 WL 1866031, at *7 (D. Conn. Apr. 18, 2018).

Avoiding Liability – Drafting Considerations

- Precision
- Lack of detail
- Handling inadequate foreknowledge and due diligence impacts
- Contingencies

How to Prevail in a Dispute

- Collect all communications surrounding the LOI, especially if LOI does not differentiate between binding and non-binding provisions
 - May be admissible as parol evidence regarding any ambiguity in the LOI
- Research and prepare to prove industry custom
- Verify past customary practices of client
- Discover past customary practices of opposing party

Relief in Event of a Dispute



- Cure Rights?
- Injunction (e.g., confidentiality breach, substitute transaction)
- Specific Performance (often not realistic)
- Damages
 - Types
 - Proof (proximate cause)

Damages – Types

- Lost opportunity/benefit of the bargain
- Out-of-pocket costs
- Reliance Damages
- Not speculative
 - Speculative damages can be more difficult to prove because of uncertainty of what further negotiations would or would not produce
- Liquidated damages
 - Specified in LOI?
 - Reasonable?
 - Not unlawful penalty?
- Others?



Damages – Types

- Generally damages for breach of a Type II Agreement have been limited to reliance
- DE Supreme Court cases (interpreting NY law) provide for expectation damages of a Type II Agreement where damages are not too speculative in nature
 - *Siga Techs., Inc. v. PharmAthene, Inc.*, 132 A.3d 1108 (Del. 2015), as corrected (Dec. 28, 2015).

SAMPLE LOI COVER SHEET – Sheet 1

The attached Letter of Intent (hereinafter, "Letter") bearing date of [MONTH, DAY, YEAR], and made by and between [PARTY 1] and [PARTY 2] (together, "Parties") regarding the described Subject is made under these letter-of-intent terms.

Subject: _____

Terms: The Parties intend in the future to form a final binding contract with regard to the said Subject, but though this Letter (including this Cover Sheet) does NOT form such a binding final contract, this Letter's legal force and effect is that, unless agreed otherwise, the final binding contract shall include:

[Option 1] ALL Letter terms.

[Option 2] ONLY those Letter terms explicitly identified as binding; but all other Letter terms shall be considered in good faith by the Parties during negotiations toward a final binding contract.

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SAMPLE LOI COVER SHEET – Sheet 2

It shall be an actionable breach of contract if a Party to the Letter shall:

- A. Refuse to bargain in good faith toward reaching a final contract; or
- B. Fail (unless waived in writing by the other Party) to meet deadlines or duties, if any, imposed by this Letter; or
- C. Refuse (unless waived, in writing, by the other Party) to accept any term or terms of the Letter due to be included in the final binding contract; or
- D. Refuse to agree to reasonable proposed final contract terms not contained in and not at variance with the Letter in order to intentionally avoid a final contract containing terms due to be included from the Letter.

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SAMPLE LOI COVER SHEET – Sheet 3

The Parties further agree that this entire Letter of Intent and all information exchanged between the Parties in the course of developing this Letter are confidential and shall not be disclosed to any third-party (unless agreed otherwise) nor used for any unlawful, illegal or unfair purpose.

Any notice to be given regarding the Subject of this Letter shall be given by any receipted means or irrevocably journalized means (including without limitation email) to the Parties at their respective addresses below the signature lines.

The Parties hereby incorporate this Cover Sheet as an integral part of the agreed and attached Letter of Intent.

[Signatures, Signature Dates & Contacts for Notice Follow]

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Resources

- May Lu and James P. O’Sullivan, “Letter of Intent: An Increasingly Valuable Tool in an Uncertain Economy”
 - <https://www.tblaw.com/wp-content/uploads/2017/03/jpo-mlu-attorney-at-law-magazine-may-2011-article-468115-2.pdf>
- Form Letter of Intent in American Bar Association’s Model Asset Purchase Agreement and Model Stock Purchase Agreement
 - Can be purchased at:
<https://www.americanbar.org/products/>





Disclaimer

- Information presented here is general information.
- Choice of the right legal strategies for your specific situation depends on your fact situation and how the law and market conditions apply to that situation.

Morris A. Nunes Biography

Maury Nunes has been in private practice since 1977 representing privately held businesses and non-profit organizations as an outside general counsel. He is admitted to the Bars of Georgia, Virginia, Maryland and the District of Columbia as well as several specialty federal courts and the U.S. Supreme Court. He currently maintains offices both in Georgia where he now lives and in Falls Church, Virginia, where he previously lived.

Maury is the author or co-author of 6 books on legal and financial subjects, as well as of dozens of published articles. In addition to his teaching for Strafford, he has also taught CLE courses for Lawline, the National Academy of Continuing Legal Education and the National Constitution Center. Additionally, he served as an Adjunct Professor in the law schools of Catholic University and Georgetown University as well as in the MBA Program in Georgetown's McDonough School of Business. Maury also hosted and produced a 42-episode weekly cable talk show on the law in Northern Virginia, entitled *General Counsel*, featuring judges, government officials, professors and prominent attorneys.

His law degree comes from Georgetown, and he holds two degrees from the University of Pennsylvania, one from its College of Liberal Arts in Political Science and one from its Wharton School of Business in Finance and Accounting.

He was also appointed by Virginia's Governor to its Virginia Board of Professional and Occupational Regulation, which oversees regulation of commercial activity in the State. After two years he was elected the Board's Chairman and reappointed by for a second 4-year term, remaining as Chair until his term expired. During his tenure, he received the Patrick Henry Award from the Governor for outstanding board service. He is also active in several charitable and community organizations, for several of which he serves in leadership.

May Lu Biography

MAY LU, a Shareholder at Tiffany & Bosco, P.A., serves the transactional needs of businesses and their owners by assisting them with business formations of limited liability companies and corporations, joint ventures, mergers and acquisitions, recapitalizations, succession strategies, general business planning, and other business agreements. Ms. Lu provides guidance to businesses concerning disputes among owners and related fiduciary duties, and she assists clients with regulatory and governance issues related to the U.S. Small Business Administration and other federal, state, and local programs.

Since 2012, Ms. Lu has been a Super Lawyers Southwest Rising Stars honoree in Mergers & Acquisitions. She is a member of the M&A Source and the American Bar Association's Mergers & Acquisitions and Middle Market and Small Business Committees, in which she is participating on a Joint Task Force to create model form business sale agreements for middle and lower middle market transactions. She is the current Immediate Past President of the Arizona Asian American Bar Association and co-chaired the State Bar of Arizona's 2017 Convention Committee.

Ms. Lu's commitment to giving back to the community includes her involvement on the Board of Directors and as pro bono General Counsel of ACLU-Arizona and volunteering with the Arizona State University Sandra Day O'Connor College of Law's Business Legal Assistance Program, for which she was awarded the 2011 Outstanding Volunteer Lawyer. Ms. Lu received her B.S., *summa cum laude*, from Arizona State University on a National Merit Scholarship and her J.D. from the University of Arizona James E. Rogers College of Law, where she was a managing editor of the Arizona Journal of International and Comparative Law.