

Letters Of Intent: Avoiding Common Problem Areas

February 11, 2017 Ricardo Garcia-Moreno, Michael Mazzone

PRACTICES Litigation

Parties in transactions large and small commonly utilize letters of intent (LOI) during the negotiation process. An LOI typically lays out the terms of a contract that the parties intend to enter in the future, but will explicitly state that the parties have not yet entered into a contract and can back out in whole or in part at any time. Although LOIs can be helpful tools in negotiating a final agreement, the cases discussed below show that LOIs can be problematic if care is not used throughout the LOI process.

Problem Area: A Binding LOI

One common problem is a document that is labeled a “letter of intent,” but is in fact a contract. This situation usually arises when one party intends a document to be nonbinding, but fails to include language in the document that denies that a contract has been formed...

Problem Area: Subsequent Actions

Another common dispute involves actions that, taken after the signing of an LOI, indicate an agreement has been formed. This arises when a party claims that it has not reached an agreement, but then acts in ways that are inconsistent with a lack of agreement. Actions taken after the signing of an LOI were recently litigated in *Energy Transfer Partners v. Enterprise Products*...

Problem Area: The Duty to Negotiate in Good Faith

The duty to negotiate in good faith requires parties to use reasonable efforts to reach agreement. If the duty is breached, it creates a cause of action separate from a breach of contract. In Texas, there is no implied duty to negotiate in good faith. The parties must create that duty contractually. Other states such as Delaware do recognize an implied duty to negotiate in good faith. Even in states where no implied duty to negotiate exists, courts have sometimes found that parties created such a duty in their LOIs...

To avoid the problems described above, lawyers should advise their clients to involve counsel early in the LOI process and to closely govern their behavior after an LOI has been signed. Although an LOI can be a helpful tool in negotiations, a party’s liability can be significantly increased if care is not used throughout the LOI process.

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