

Legal Risk Management Tip

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Letters of Intent and Term Sheets: M&A Risks and Best Practices for Buyers and Sellers

Introduction

When entering a [merger or acquisition](#), the number one role of counsel is to protect clients from unnecessary risk, which begins with the Letter of Intent (“LOI”) and Term Sheet. Each serves as a foundational piece of a successful M&A transaction. When a party approaches the LOI as merely a temporary, informal preface to a definitive agreement, it can put that party at a disadvantage and complicate or undermine the successful consummation of the transaction.

The Role of an LOI

An LOI establishes the roadmap for the definitive agreements and is a crucial step in mergers, acquisitions, and other corporate transactions.

It outlines the expectations of both parties and key deal terms while negotiations proceed, including the deal structure, financial terms, the scope and timeline of due diligence, conditions to closing, management and employment arrangements, representations and warranties, indemnification, and much more. Importantly, it also specifies which provisions of the LOI are intended to be binding legal obligations on the parties prior to the execution of a definitive agreement.

Key Risk Areas in LOIs

LOIs do not establish all of the specific terms of definitive M&A agreements; however, they provide a framework for negotiations that can significantly influence the provisions of those agreements. If the framework does not accommodate a party’s desired terms, it can substantially affect the outcome of the final agreement.

There are several concentrated areas of operational, legal, regulatory, and financial risk that affect buyers and sellers, often in opposite ways.

1. Buyer Risks

Buyers face the risk of paying for value that does not ultimately transfer. Purchase price, including any deferred payments, should be clearly defined and tied to what will be tested in due diligence. When client relationships are involved, that value depends on client consent and transferability, making it important for the LOI to address how client consents will be obtained and who bears the risk if clients do not consent or follow the business.

Personnel is closely related. In wealth management and other relationship-driven businesses, client relationships often rest with individual advisors, such that retention and non-compete and non-solicit terms should be addressed early.

Finally, the regulatory landscape matters, since regulatory review and approvals can affect both the timing and the feasibility of closing and should be considered at the LOI stage.

2. Seller Risks

Sellers face the risk of giving up leverage while the buyer keeps its options open. Exclusivity is the clearest the buyer conducts diligence and decides whether to proceed.

Financing contingencies compound this risk, because a buyer without secured financing may be able to tie up the seller and ultimately walk away if financing is not obtained. Payment terms and mechanics also determine what the seller will actually receive and when, while vague definitions can become a source of later disputes.

Confidentiality is critical as well, since a leak to employees or clients can cause damage even if the deal never closes.

Best Practices

A well-drafted LOI can offer strong safeguards that extend throughout negotiations and the final agreement. Here are key best practices to protect yourself.

In M&A, the LOI stage presents a situation in which each party can gain leverage at the expense of the other. However, knowledgeable corporate counsel will help you protect your business interests without making the deal process unnecessarily adversarial, potentially damaging your relationship with the other party or jeopardizing the successful consummation of the transaction.

Both buyers and sellers should treat the LOI as a preview of the definitive agreements and include any essential elements of the deal. Even more importantly, potential deal-breakers or red flags should be identified and addressed early, to determine whether the parties are a good fit. It is generally far less costly to walk away during the LOI stage than after months of negotiating, conducting diligence, and incurring transaction expenses.

Buyers

The LOI can be used to affirmatively establish the most favorable terms from the outset. At the same time, the key best practice is to use the document to minimize buyer risk. This can be accomplished through broad exclusivity provisions, limited binding obligations on the buyer, and appropriately tailored closing conditions and contingencies.

Sellers

A key safeguard for sellers is limiting the duration of any exclusivity period—often to 30 to 45 days—and preserving appropriate rights to terminate the transaction. Equally important is addressing the methodology for determining the new working capital peg, earn-out triggers, payment mechanics, and other critical economic issues.

The LOI may be a relatively short document, but it plays an important role in setting the tone and framework for the deal from the outset. Thoughtful negotiation at this stage can prevent months of dispute later, or even save the transaction itself.

Risk Management Tips for RIAs Entering Into an LOI

Generally, an LOI should address the matters set forth below. If it does not, be sure to at least discuss with the buyer or seller the following:

- The definitive agreements that will be entered into (e.g., asset purchase agreement, promissory note, personal guaranty, etc.)
- The assets or equity to be purchased
- The purchase price and any purchase price adjustments
- Any earnout or other contingent consideration, including applicable conditions
- Whether the seller will continue as an employee or independent contractor
- Anticipated closing date and closing conditions
- Restrictive covenants to be considered
- Allocation of transaction expenses
- Representations and warranties
- Indemnification rights and limitations
- Exclusivity
- Confidentiality
- Other material deal terms

If you are considering a sale, merger, or acquisition, it is recommended to involve experienced corporate legal counsel to navigate the transaction from the LOI through closing.

For more information on how Jacko Law Group's M&A lawyers can assist you in your next transaction, please contact us at 619.298.2880 or email info@jackolg.com.

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