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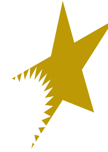

Letters of Intent - Be Very Clear and Careful About What You Might Wish For

by Sundeep Sandhu
Originally published in *Blaneys on Business* (June 2009) - **Read the entire newsletter**

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The Court of Appeal for Ontario has issued an important caution to business people who regard a letter of intent (LOI) as only an "agreement to agree" to a proposed deal and not as a binding commitment to that deal.

The caution is this – be *very* careful, not only about the wording of the LOI, as such, but about what you say and how you behave in relation to it. If you are not careful, you may discover that phrases in the LOI itself and accompanying words and actions can essentially serve to turn what you look upon as a provisional document into a binding one.

This caution flows from the appeal court's reversal earlier this year of the superior court decision in *Wallace v. Allen*, ("*Wallace*"), which was discussed in Blaneys on Business last autumn.

Trial Decision

If you recall, it was in *Wallace* that the trial judge found that the sellers of an environmental services business, Graham and Gayle Allen, and the buyer, Kim Wallace, who were friends and neighbours, were not bound to complete the sale of shares of Allen's companies, even though the parties had nearly concluded the transaction.

After Mr. Allen refused to sign two early drafts of an LOI because "there remained too many things up in the air", the parties eventually did enter into an LOI setting out almost all of the essential terms of their agreement. Shortly thereafter Mr. Wallace began to attend the business premises daily with a view to learning the business, getting to know the customers and staff and doing everything necessary to provide a smooth transition in the company's ownership. The parties had also met after a draft of the share purchase agreement was circulated to expressly deal with any outstanding issues.

The trial judge found that all the issues between the parties to form part of the share purchase had been dealt with prior to the closing. In fact, Mr. Allen admitted that he felt obliged to complete the transaction on the day of the closing and was there to sign the necessary paper work. However, he refused to close after he was told that Mr. Wallace had not signed the necessary documentation and had not placed any money in trust to close.

The LOI included a clause requiring that the terms be reduced to a binding agreement of purchase and sale within 40 days, and a clause stating that "there will be much legal work to be done… and that the wording of this agreement may alter somewhat." This is not unusual, as LOIs are typically used as an initial means of establishing a relationship without having the parties commit to legally binding obligations until the details of those obligations have been negotiated. They are simply

"agreements to agree" and postpone any legal liability until the details of the final agreement have been negotiated. As a result, the courts have historically refused to enforce LOIs.

The trial judge concluded that, from the perspective of an objective, reasonable observer, considering (a) the circumstances giving rise to the LOI, (b) the wording of the LOI, and (c) the conduct of the parties, that while the LOI contained all the essential terms, it did not constitute a binding contract. The parties had merely entered into an agreement to agree and, as such, had not yet demonstrated that they intended to be bound by the LOI. As the parties did not sign the final form of the purchase and sale agreement that they had negotiated, no final agreement had been made.

Court of Appeal

The Court of Appeal set aside the trial judge's decision, concluding that, read as a whole the parties did, indeed, intend to be bound by the LOI. The court concluded that the trial judge had essentially failed to apply the presumption in law that an individual who executes a commercial document intends to be bound by it, and that the judge's construction of the LOI defeated the parties' expectations and was contrary to the weight of evidence presented at trial.

The court found that the LOI plainly expressed an intention on the part of the parties to be bound by its terms, which were to be incorporated into a more formal document. It pointed out that the language in the LOI referenced "this agreement," suggesting that the substance of the LOI was acceptable to the parties and that only the wording would be altered in the drafting of a binding agreement of purchase and sale. Mr. Wallace further explained that "the need for much work to be done", as referenced in the LOI, meant that, as learned through his previous purchase experiences, the actual formal agreements in purchase transactions tend to be lengthy and numerous in nature.

Furthermore, the court concluded, the conduct of the parties after the signing the LOI clearly demonstrated that they intended to be bound by its terms. Mr. Wallace had started work in the business, going beyond simple due diligence. In addition, at a special meeting of employees and at the company Christmas party, Mr. Allen had announced his retirement and the sale of business and had introduced Mr. Wallace as the new owner. All outstanding issues had been addressed in a meeting set up for that express purpose prior to the closing date.

The Court of Appeal's reversal of the trial court's decision in *Wallace* emphasizes the value in seeking advice from counsel as to whether it is, first, desirable to have a legally enforceable LOI; second, whether the specific LOI in question is, in fact, a legally enforceable agreement; and third, what words and behaviours, post-signing, will serve to reinforce the intentions of the parties to the LOI. ■