

How Firm Is Your Handshake? Letters of Intent in M&A

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Does “shaking on it” mean you can you still change your mind?

You signed a non-binding letter of intent. Weeks later, negotiations to finalize the deal have stalled, and you’re starting to lose interest in the transaction. Are you obliged to reach a definitive agreement even though your letter of intent says it is non-binding?

In Canada, an agreement to negotiate in the future is generally unenforceable, so long as all essential terms have not been agreed upon and the parties did not intend to create a binding contract.

But that is not the end of the story.

A genuine absence of good faith by one party to negotiate a deal *may* be scrutinized by the courts, even in the context of a non-binding letter of intent or term sheet.

The Supreme Court of Canada recently decided that there is a new general organizing principle of good faith performance, and that parties to an existing contract have a duty of honest performance.

Simply put: parties must perform their contractual duties honestly and reasonably, not capriciously or arbitrarily. And they must not lie or mislead each other about matters related to the performance of the contract.

While the Supreme Court decision concerned an executed contract—not a letter of intent—the dispute related to a party’s discretionary exercise of a non-renewal clause under which it had no binding obligation to renew. As a result, it’s not out of the realm of possibility for Canadian courts to extend good faith principles to letters of intent as they continue to refine the scope of this new duty.

In fact, in the U.S., Delaware courts recently not only recognized an obligation to negotiate in good faith when expressly written in a non-binding term sheet, but they also awarded damages for lost profits when the parties would have reached a definitive agreement but for the breaching party’s bad faith negotiations.

Proving dishonesty can be an uphill battle, but given the risk of court scrutiny at play (and the potential liability for damages that could ultimately result), parties signing a non-binding letter of intent in Ontario should take steps to protect themselves. How?

1. The letter should recognize that the parties have no contractual obligations (subject to appropriate exceptions, like confidentiality, exclusive dealings and expenses), and no good faith duty to negotiate a definitive agreement.
2. Terms and conditions that must be met before a binding contract is established can be identified in the letter, underscoring the non-binding nature of the letter.

3. The parties can consider restricting the damages that may be recovered if one of them is subsequently found to have acted in bad faith (e.g., by excluding damages for lost profits).



Tip

If you want your letter of intent to be non-binding, say so. Identify terms to be negotiated, limit recoverable damages—and make it clear that you have no good faith duty to close on a handshake.

*With assistance from [Crystal Chung](#).