Letters of intent in the M & A context

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Introduction

With the increasing number of mergers and acquisitions during the last two decades, the letter of intent, which precedes most forms of acquisitions of businesses, has become a widespread tool and, indeed, is often considered as a *sine qua non* condition of any merger or acquisition (M&A). Nevertheless, this institution still enjoys - or suffers from - an almost total absence of specific regulation in Swiss law, while its purpose, nature and effects are often uncertain and misunderstood.

This paper attempts to provide an update on the legal status of letters of intent in a Swiss law perspective, and will focus on their use in an M&A context. Confidentiality provisions or agreements, a common or related feature, will also be discussed. Emphasis will be placed on the practical consequences stemming from both instruments.

Letters of intent are usually executed between the end of the exploratory negotiations and the beginning of due diligence. Thus, they govern due diligence but also the contractual negotiations which will flow from - and frequently overlap - the due diligence process, ultimately (and ideally) resulting in the acquisition contract.

1. **Notion, delimitations and distinctions**

1.1. **Notion**

Whenever negotiations are pursued they usually reach a stage where the parties wish to record their common intentions with respect to the nature of the envisaged deal, its main conditions and the process which will lead to the execution of the actual purchase agreement.

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2 Attorney-at-Law.
3 See herein, Henry Peter, M&A transactions: process and possible disputes, § 2.1.2.
4 As well as, to our knowledge, in most other countries.
6 See herein, Henry Peter, M&A transactions: process and possible disputes, § 2.1.1.
7 See herein, Henry Peter, M&A transactions: process and possible disputes, § 2.1.
8 For a description of the M&A process, see herein, Henry Peter, M&A transactions: process and possible disputes, § 2.1 and Schedule 1.
9 On terminology and the various uses of the letter of intent generally, see also, Ralph Lake/ Ugo Draetta, p. 3 to 17.
At this stage the negotiations process is generally characterised by a conflict of interests - or at least contrasting positions - between the seller and the buyer:

- *The seller* is anxious to sell its business quickly and safely. He is willing to sell to the (potential) purchaser and is usually ready - or at least required - to negotiate exclusively with him, which puts the seller in a somewhat vulnerable position;

- in contrast, *the buyer* will, obviously, not commit before he has had a chance to get to know the business in depth. His concerns are both *objective* - is the business financially sound? - and *subjective* - will the business match the buyer's own business and/or commercial strategy? The outcome of this inquiry will have an impact not only on the decision to buy, but also on the conditions of sale, including, obviously, the price, and other contractual provisions, not the least of which are the representations and warranties and related indemnity clauses.

The letter of intent has developed over the years into the appropriate instrument to satisfy both parties' concerns. It plays a significant role - from a psychological standpoint at the very least - by documenting the facts and reassuring the parties that the negotiations - which often involve considerable expenses and commitment - are based on a serious and shared intent.

Hence the letter of intent, as appraised by this paper, may be defined as a declaration of intent of one or more parties to conclude a transaction, in which certain fundamental aspects of such envisaged transaction and of the procedure that should lead to its conclusion are recorded. Letters of intent can portend any kind of deal, for instance the acquisition of shares, of assets, of a business, as well as a merger or a joint venture.

1.2. Delimitations and distinctions

1.2.1. Unrelated Instruments

A first delimitation may be drawn between letters of intent, as assessed in this paper, and other instruments known under the same name but pursuing a fundamentally different purpose. In fact, in French the term "letter of intent" is sometimes used to designate "comfort letters" (lettre de confort, lettre de patronage, Patronatserklärung), i.e. letters issued by a party in favour of another by which the issuer makes certain statements and/or supplies certain information, typically regarding its shareholding and the solvency of a subsidiary. We consider that the use of "letter of intent" in the sense of...
"comfort letter" is improper; some authors however do acknowledge the double meaning of this expression.\(^4\)

Although the boundaries are often unclear, other possible sources of confusion include instruments, at times improperly called "letters of intent", which are actually gentlemen's agreements.\(^5\)

1.2.2. Related Instruments

Letters of intent have further to be distinguished from other instruments which pursue, at least in part, the same purpose but perform a different function, such as option agreements or confidentiality agreements.

1.2.2.1 Options

The option agreement has been defined as an agreement by which one of the parties grants the other a discretionary right to generate, by its sole declaration of intent, a given contract.\(^6\)

1.2.2.2 Confidentiality agreements

It is inevitable that, if the negotiations are pursued, they will reach a stage where the potential buyer will expect to have access to certain confidential information regarding the subject matter of the prospected deal (the "target"), whereas the potential seller will be concerned by the disclosure of such information to competitors (including the potential buyer) especially if the negotiations ultimately fail. The sensitive information often includes the very fact that negotiations are being conducted.

The apprehensions with respect to confidentiality have to be dealt with at an early stage, usually before the parties are even ready to execute a letter of intent. This is why, although the confidentiality provisions can be part of the letter of intent, they often take the form of a separate and preliminary document\(^7\) the content of which will be briefly noted below.

\(^{14}\) Thus in French, such an institution appears to be indifferently known as "lettre d'intention", "de patronage", "de confort" or "de parrainage". For Swiss law, see e.g. ARNE SCHOLLEN, Les lettres de parrainage ont-elles toujours de bonnes intentions ?, RDAI 1994, p. 793; ROLAND RUEDIN, La lettre d'intention en droit suisse, in Hommage à Paul-Rene Rossel à l'occasion de son 70ème anniversaire, Neuchâtel 1977, p. 213 to 228 (on comfort instruments). For French law, see e.g. PHILIPPE SIMLER, Cautionnement et garanties autonomes, 2nd ed., Paris (Litel) 1991, p. 28; MICHEL CABRILLAC / CHRISTIAN MOLLY, Droit des sûretés, 5th ed., Paris (Litel) 1990, p. 357. For U.S. law, see e.g. LARRY A. DIAMETTE / RENÉ SACASAS, Credit and Value Comfort Instruments: Crossing the Line from Assurance to Legally Significant Riallastence and Toward a Theory of Enforceability, 47 Baylor l. Rev. 357. See also RALF SCHLOSSER, p. 348; MARKUS LUTTER, Der Letter of Intent, Köln 1992, p. 12.

\(^{15}\) The gentleman's agreement has been defined as an understanding by which the parties commit themselves to moral obligations, i.e., to refrain from resorting to judiciary enforcement. See RALF SCHLOSSER, p. 348 and note 14.

\(^{16}\) See RALF SCHLOSSER, p. 346 and 347 and notes 6 and 7. Besides all which are more or less standardised, put and call options, such agreements are found, e.g., in the context of technology transfers, where the potential buyer shall have the right to appraise the know-how of the potential seller, and then to exercise his option at the time it believes appropriate.

\(^{17}\) See herein, HENRY PETER, M&A transactions: process and possible disputes, § 2.1.1.
The key provisions of a confidentiality agreement are generally the following:

- **Identity of the parties.** These are usually the buyer and the seller. Occasionally, the target is also a party so that it may directly claim performance – or compensation – in the event of breach. Third parties may also be required to sign the confidentiality agreement, such as advisors or managers of the parties, including sometimes those of the target.

- **Scope.** The parties undertake to keep the confidential information secret and to use it strictly in compliance with the purpose of the agreement, i.e. the acquisition of the target.

- **Confidential Information.** The definition of what is deemed to be confidential is a key provision. The mere existence of negotiations between the parties is often expressly designated as being confidential.

- **Abortion.** The fate of the information, and the related documents, is usually provided for should the acquisition not ultimately take place.

- **Applicable law and dispute settlement.** Applicable law and jurisdiction are, in most cases, specified.

1.2.3. **Variations in Terminology**

Several other expressions, such as memorandum of understanding, memorandum of agreement, heads of agreement or term sheet are encountered. The situation is hardly clearer in other languages: **Punktuationen** in German, **protocole d'accord** in French, etc. For the purpose of this paper, suffice it to note that there seems to be no general understanding on whether these expressions represent substantially different instruments or are only variations in terminology. And even if a certain consensus exists amongst academics, uncertainties often remain at the practitioner's level.

In any event, and this is the main point, pursuant to a well-established principle of Swiss law, intent prevails over wording. Thus, what matters is not the title of the document but its actual content as construed taking into account the parties' intentions.

1.2.4. **Pre-Contractual Agreements and Promises to Contract**

Pre-contractual agreements are defined as agreements made between two or more negotiating parties, seeking to arrive at the conclusion of a final contract.

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16 See RALF SCHLOSSER, p. 347 and 8 and notes 11 to 13; URS SCHENKER, **Due Diligence beim Unternehmenskauf,** in Mergers & Acquisitions III, Zürich 2001, p. 209, especially p. 220 and 221; RALPH LAKE/UGO DRAETTA, p. 5.

17 See RALPH LAKE/UGO DRAETTA, p. 9 and note 27.

18 Art. 18 CO. See infra § 4.2.

19 RALF SCHLOSSER, p. 345. Also known as preliminary agreements in Anglo-Saxon legal terminology, **contrats de négociation** in French and either "Vorausvertrag" (to distinguish from "Vorvertrag", i.e., promise to contract), or "Vertragsverhandlungsvereinbarung" in German.
Promises to contract are regulated by art. 22 CO pursuant to which the parties may contractually commit themselves to conclude a contract in the future\textsuperscript{22}.

Whereas these notions are akin and sometimes overlapping with that of letters of intent, they are distinct legal concepts as will be discussed below.

1.2.5. Bilateral (or Multilateral) and Unilateral Letters of Intent

Letters of intent are usually bilateral, i.e. they are executed by two parties — the (potential) seller and the (potential) buyer. Occasionally, they may be signed by more parties, for instance by several companies which are acting in concert or belonging to the same group, sometimes also by the target, in which cases the letter of intent may be described as multilateral.

Less frequently, a letter of intent may be unilateral, i.e. emanate from only one party, either the seller or the buyer, expressing a party's intent to sell or to buy\textsuperscript{23}. How the latter qualifies legally will be addressed below.

2. Content

There is no standard pattern. Letters of intent vary considerably in form and substance. Certain basic provisions may, however, be identified and classified as "necessary" clauses, others as "optional" clauses.

2.1. Necessary Clauses

Necessary clauses usually include the following items:

- identity of the parties: who are the envisaged seller and the purchaser of the target?
- object of the transaction: what business, or part thereof, does the transaction relate to?
- nature of the transaction: what kind of transaction are the parties envisaging? A share deal, an asset deal, a capital increase, a spin off, a leveraged buy-out, the setting up of a joint-venture (whether corporate or contractual)?
- process: how is the envisaged transaction going to be achieved (a due diligence first, then the signing of a purchase agreement, thereafter a closing, etc.), what will the calendar be, etc?

2.2. Optional Clauses

Optional clauses may include the following items:

\textsuperscript{22} Lat. "pactum de contraueri"; Fr. "précontract"; Ger. "Vorvertrag" (to distinguish from "Vorausvertrag", i.e., pre-contractual agreement). In order to avoid confusion, in this paper we shall exclusively use the expression "promise to contract".

\textsuperscript{23} RALF SCHLOSSER, p. 356 and 357.
- sale price (sometimes an exact figure, more often an estimate or range, valuation principles or the formula for determining the price, etc.)\textsuperscript{24};
- due diligence (scope, time schedule and procedural or methodological issues)\textsuperscript{25};
- exclusivity ("lock in\textsuperscript{26} and/or "lock out\textsuperscript{27} );
- non-inducement\textsuperscript{28};
- costs;
- confidentiality (if not the subject matter of a separate agreement);
- applicable law and dispute settlement, including forum;
- compulsory nature of the letter of intent (none/partial/total).

3. Legal nature

The letter of intent is, as indicated by its very name, of a voluntary nature. Whether it has binding effects is a delicate and often controversial issue. We will, consecutively, discuss whether it can be considered a "full" contract (infra § 3.1), a promise to contract (infra § 3.2) or an offer (infra § 3.3).

3.1. Is the Letter of Intent a Contract?

Pursuant to art. 1 § CO, a contract exists when the parties have reciprocally expressed matching intentions. To that effect it is sufficient for them to agree on the main elements of the deal (essentialia negotii)\textsuperscript{30}. If secondary issues have not been agreed, they may be determined by the judge (art. 2 § 2 CO).

It is usually considered that a letter of intent is not an agreement. This is due to the fact that, in a standard M&A pattern\textsuperscript{31}, letters of intent are meant to describe an envisaged transaction, not to confirm an agreed one. To dispel any doubts in this respect, this concept is often expressly indicated in the wording of letters of intent, by stating, for instance, that the deal is "subject to contract". The parties thus only express intentions, not decisions. The intent is to negotiate and – possibly – to conclude a final contract, without prejudice to the parties’ discretionary right not to do so.

\textsuperscript{24} RUDOLF TSCHÂNI / ANDREAS VON PLANTA / MATTHIAS OERTLE, Corporate Acquisitions and Mergers in Switzerland, Zürich 2000, p. 83 and 84, § 385 to 400 consider the price (or a formula enabling to determine the price) as an "essential point" of the letter of intent.
\textsuperscript{25} See herein HENRY PETER, M&A transactions: process and possible disputes, § 2.1.3.
\textsuperscript{26} The seller must negotiate with the buyer during a certain period of time.
\textsuperscript{27} The seller must not negotiate with third parties during a certain period of time.
\textsuperscript{28} This provision generally specifies that it shall cease to be binding as soon as a party declares in writing its intent to depart from the negotiation.
\textsuperscript{29} The potential buyer undertakes not to hire or induce away managers or employees of the target. See Urs SCHENKEN, p. 219.
\textsuperscript{30} ATF 103 II 190 (1977) c. 1 = JdT 1978 I 157 (summary). The judge may, however, exceptionally fix disagreements in accordance with the rule of good faith, i.e. by applying the principle of confidence, see infra § 4.2.
\textsuperscript{31} See herein, HENRY PETER, M&A transactions: process and possible disputes, § 2.1.
However, often this does not—or at least not completely—stand up under closer analysis. The answer is a question of interpretation for which the rules of good faith (art. 2 §1 CC) play a central role. Applying the "principle of trust", the parties' intent will be interpreted according to their actual understanding, with a particular view to that of the addressee, bearing in mind the overall circumstances.  

In order to assess whether the letter of intent qualifies as a contract, a number of preliminary distinctions should be made with respect to its provisions. Firstly, the provisions typically contained in a letter of intent, as listed above, whether necessary or optional, can be divided into two categories: those which govern the negotiation of the final contract, irrespective of its outcome, and those which pertain to its actual implementation.  

(i) The provisions belonging to the first category (negotiation) involve the way negotiations will be conducted and related issues. These are, in particular, the following:
- description of the process;
- confidentiality;
- exclusivity;
- costs;
- applicable law and dispute settlement;
- non-inducement.

In most cases such provisions are intended to be binding, and whether this is expressed or implied is not relevant. To this extent, the letter of intent is, therefore, an agreement.

(ii) The second category (actual implementation) includes all clauses contained in the letter of intent which describe the actual (intended) deal, especially the envisaged target and the price. These provisions are not necessarily vague, and, on the contrary, sometimes the object and the price of the transaction, i.e. its essentialia negotii, are already quite clearly identified. What characterises a letter of intent is that the parties wish to preserve their discretionary right not to complete the deal or to do so at conditions which could be different from those initially envisaged.

The —still to be performed—due diligence will play a fundamental role in that respect. Thus, the actual purchase agreement still has to be agreed on and stipulated. This is never a formality in M&A transactions, quite the opposite. Any practitioner has experienced how fierce negotiations can be at this later stage, especially with regard to the representations, warranties and indemnification.

32 See infra § 4.2.
provisions, to the extent that we would even suggest that, in M&A transactions, such clauses should also be considered *essentia nego*ti.*

In short, it can probably be said that the letter of intent is not binding as far as the provisions belonging to this second category are concerned. Any conclusion in this respect will, however, depend on the circumstances and on the actual intentions of the parties, whether expressed or implied. There might indeed be cases where a different conclusion could be reached.

Assuming that, in whole or in part, the contractual nature of a letter of intent has been assessed, a further question which might arise is the nature of the contractual relationship. Is it (i) *synallagmatic*, i.e. giving rise to an exchange of certain things (e.g. shares against cash) or rather (ii) something akin to a *partnership* whereby it is considered that both parties are joining their efforts in order to achieve a common goal (e.g. setting up a joint venture)?

The question is not at all academic. Should it be considered that the relationship is *synallagmatic*, the ordinary contractual regime will apply (art. 97 et seq. CO). Should it be considered that a letter of intent generates a partnership, art. 530ss CO will govern the relationship.

It would go beyond the scope of this paper to pretend to solve this issue, which is yet quite unexplored. We believe that, here as well, the answer will be fact-driven. If, for instance, the parties' intention is to enter into a share purchase agreement, the nature of the relationship is undoubtedly *synallagmatic* 33. If, on the other hand, their purpose is to set up a contractual joint venture, to the extent that a letter of intent is binding, if anything by analogy, it could be considered that the provisions of Swiss law governing partnerships do apply 34. This said however, it would probably be wrong to consider that the simple fact that the parties are willing to achieve a common goal (a certain M&A transaction) means that they are joining efforts to achieve this common goal and that, accordingly, art. 530 et seq. CO apply.

If a letter of intent is not considered a contract, in whole or in part, the question can arise as to whether it may qualify as a *promise to contract*.

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34 *Claude Reymond, Le contrat du "Joint Venture", in Innominalverträge, Zürich 1998, p. 383 to 386.*
3.2. Is the Letter of Intent a Promise to Contract?

The promise to contract is covered by art. 22 CO, i.e. the case in which parties undertake to conclude a contract in the future. The contents and scope of such a promise are disputed, however.

Traditionally, the Swiss Federal Court has deemed that a promise to contract had to include all the essentialiae of the final contract. A minority of scholars dissented, maintaining that a promise to contract may contain only part of the main elements of the final contract, or all of them but with a lesser degree of precision.

In a 1977 case, said Court found that since the promise to contract contained all the main elements, it was equivalent to an enforceable final contract. In an obiter dictum, the Court cast serious doubts about the very purpose of promises to contract. Acknowledging the criticisms raised by scholars, the Court stated the following alternative: either an agreement contains all essentialiae and therefore is a final contract, not a mere promise to contract, or there is no agreement on all essentialiae and, therefore, the parties cannot be bound to execute a contract the main content of which is not sufficiently clear. Even though the Court was cautious not to rule on such an alternative, this jurisprudence can probably be regarded as voiding the promise to contract of any practical substance.

Accordingly, if a letter of intent contains a commitment to conclude the final contract, then the following distinction should be made: either the letter of intent contains all the essentialiae negotii and might, therefore, qualify as a binding agreement, or it does not and is not a contract and thus is not binding.

3.3. Is the Letter of Intent an Offer?

Conceivably, the letter of intent may express the intent only of its author. This happens when one party (usually the potential buyer) is invited by the seller to express the conditions at which it would be ready to acquire the target. This may occur at any point in time, usually in the initial phase of the process, often in a bidding context.

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35 ATF 31 II 640 (1905).
36 See supra footnote 30.
37 ATF 103 III 97 (1977), Blum v. Bancofin, at 106 and 107. See also infra footnote 68.
39 See RALF SCHLOSSER, p. 350 and note 23; THEO BUHL / ALFRED KÖLLER / ANTON K. SCHWYZER / JEAN NICOLAS DRUEY, Das schweizerische Obligationenrecht, 9th ed., Zurich 2000, p. 109, N. 16; PIERRE CAVIN, La vente, l'échange, la donation, TDPS VII/1, Fribourg 1976, p. 146; PIERRE ERNEST, Traité des obligations en droit suisse, Bern 1997, p. 181 and 182. Following ERNST A. KRAMER, Berner Kommentar, VI/12/1a, Bern 1990, ad art. 22 CO, N. 98, the promise to contract now only makes sense where it expresses the commitment of one of the parties to the other to conclude a contract with a third party.
40 See herein HENRY PETER, M&A transactions: process and possible disputes, § 2.1.1.
For a contract to be concluded, an offer has to be accepted (art. 1 §1 CO). If the offer contains a deadline for its acceptance, the author is bound until the expiry thereof (art. 3 §1 CO). Absent such a time limit, the offeror will be bound until he can, according to business usages, reasonably expect a reply (art. 5 §1 CO). Tacit acceptance is only exceptionally admitted (art. 6 CO); it will however be excluded if it is customary, in the relevant business, to expect a written answer\(^{41}\), which is typically the case in the field of M&A.

Consequently, provided that all other conditions are met, a unilateral letter of intent may qualify as an offer. If the offer is accepted, and it contains all essential points (art. 2 §1 CO) and is not subject to other discretionary conditions, the letter of intent may give rise to a contract\(^{42}\). If there is no timely acceptance or if the offer is refused, there will be no contract.

4. Legal Effects

A letter of intent can have legal effects irrespective of the fact that it can be qualified, in part or as a whole, as a contract.

4.1. Pre-Contractual Duties

First of all, obligations derive from the rules of good faith (art. 2 and 3 CC) on the basis of the principles elaborated by the doctrine and case law with respect to the culpa in contrahendo.

As soon as they start to negotiate, the parties must observe pre-contractual duties, i.e. each party must take utmost care to behave like a fair partner and to avoid any undue damage to the other party. This is sometimes expressly indicated in clauses of the letters of intent stating that the parties shall "negotiate in good faith" or "endeavour their best efforts" to achieve the envisaged transaction\(^{43}\). It could therefore be said that such provisions of letters of intent are nothing else than a codification of the duties already expressed in the preliminary part of the Swiss civil code. Seen from this perspective, these provisions of the letter of intent would be redundant.

However, we suggest going further and considering that the letters of intent should be interpreted as a reinforced commitment of the parties to act and, in particular, to negotiate in good faith\(^{44}\). By signing a letter of intent, the parties create qualified expectations. This implies the need for qualified good faith in M&A cases.

There are two situations in which pre-contractual duties may arise: (i) during the negotiation of the letter of intent itself and (ii) during the negotiation of the final agreement following the execution of a letter of intent. If, however, the duty to negotiate


\(^{42}\) RALF SCHLOSSER, p. 356 and 357 and note 50; MARKUS LUTTER, p. 19 to 23; P. SIEBOURG, p. 155 to 158.


\(^{44}\) See RUDOLF TSCHÂNI, p. 17, N. 4.
in good faith is provided for by the letter of intent, it could also be treated as a contractual obligation, not as a pre-contractual duty.\(^45\)

Pre-contractual obligations include:

- a **duty to act honestly**\(^46\): the parties should not negotiate without the genuine intent to conclude a final contract\(^47\).

- a **prohibition to deceive**: a party may not deceive the other party. A *culpa in contrahendo* would exist in the event a party alleges — or implies — that it is concluding parallel negotiations whereas this is untrue. This behaviour sometimes occurs in an attempt to create a fake auction process in order to increase (or decrease) the price.

- a **duty to inform**: each party must inform the other of facts that the latter does not know which may recognisably have an impact on its decision to enter into the deal or on the terms thereof\(^48\). Also, each party has a duty to inform the other whenever it has decided *not to conclude* the agreement. In the case of mergers and acquisitions, the reinforced requirement of good faith noted above would imply that the range of such information covers anything which significantly contributes to the decision making of the parties, unless the other party can be expected to obtain such information on its own\(^49\).

Issues concerning the duty to inform in connection with a letter of intent frequently arise in the case of *parallel negotiations*\(^50\). The doctrine however diverges as to whether conducting parallel negotiations is admissible at all\(^51\) and, if so, as to whether there is a duty to inform the other party and to what extent\(^52\).

The Swiss Federal Court has ruled that a subsidiary that negotiates for months without informing its counterpart that the final decision lies with a third party (*in casu* its mother company) is liable in the event such a decision is ultimately

\(^{45}\) Provided that the letter of intent, at least in that respect, qualifies as a contract.


\(^{47}\) ATF 46 II 373 (1920) = JdT 1921 I 42.

\(^{48}\) ATF 102 II 80, B 4 (1976).

\(^{49}\) ATF 105 II 80 (1979).

\(^{50}\) RUDOLF TSCHÂNI / ANDREAS VON PLANZA / MATTHIAS OERTLE, p. 83, N. 397. For a detailed assessment of the information the seller has a duty to disclose or the buyer has to find out by himself, see MARKUS VISCHER, *Due Diligence bei Unternehmenskäufen*, SJZ 96 (2000) No 10 p. 229. VISCHER focuses on due diligence, but the principles he identifies apply *mutatis mutandis* to the letter of intent.

\(^{51}\) See RUDOLF TSCHÂNI, p. 17, N. 4 to 6.


\(^{53}\) RALF SCHLOSSER (p. 361), for instance, believes that the parties to a letter of intent have a *reinforced* duty to inform their counterpart in case of parallel negotiations, i.e. not only of their existence, but even of the content of any offer.
negative and thereby causes prejudice to the other party\textsuperscript{54}. On the contrary, the Court rejected a claim from the seller on the grounds that the buyer had not informed the seller of its intention to re-sell the company immediately after the (initial) acquisition\textsuperscript{55}.

- a duty to advise: particular knowledge held by one party must benefit the other. The duty to advise may be seen as a particular form of the duty to inform\textsuperscript{56}.

4.2. Contractual Interpretation and Completion

Once the contractual nature of the letter of intent has been determined, the letter of intent will be interpreted whenever the parties are in disagreement as to the scope of their rights and obligations. The rules governing contractual interpretation and completion are a typical expression of the general principle of good faith.

When the parties' intent is expressed but is unclear, the parties and, as the case may be, the judge, will assess it. When such intent is not expressed and cannot be construed, and provided all \textit{essentialia negotii} are agreed on\textsuperscript{57}, the judge will complete (in French, "compléter"; in German, "ergänzen") the contract\textsuperscript{58}.

Pursuant to art. 18 §1 CO, the judge will seek the real and common intention of the parties. The judge will consider the overall circumstances surrounding the contract, its conclusion and performance. If the intent of the parties is neither expressed nor implied, the judge will have to decide the hypothetical intent of the parties, considering the nature of the deal (art. 2 §2 CO) and relying on the rules of good faith (art. 2 §1 CC). In doing so, he will consider what is customary in the field of M&A in general, taking into account the relevant transaction in particular\textsuperscript{59}.

4.3. Remedies and Liabilities

The legal consequences of the non-performance of a letter of intent will mostly depend on its nature. Two types of liability may arise: contractual liability and pre-contractual liability.

4.3.1. Contractual Remedies and Liability

To the extent that a letter of intent can be considered a contract, with binding effects, therefore, art. 97 et seq. CO shall apply.

\textsuperscript{54} ATF 105 II 75 (1979), 60.
\textsuperscript{55} SJZ 1976, p. 360.
\textsuperscript{56} ATF 68 II 302 (1942). See also PIERRE TERCIER, \textit{Le droit des obligations}, Zürich 2004, p. 124, N. 577 et seq.
\textsuperscript{57} For instance, sometimes the parties state that "customary representations and warranties" shall apply. We have suggested (see above 3.1) that, in M&A transactions, "Reps and warranties" are \textit{essentialia negotii}. Thus, if the provision is not sufficiently clear, we believe that it will be difficult to deem that there is a contract.
\textsuperscript{58} ATF 110 II 267, JT 1985 I 146; ATF 11 II 260, JT 1986 I 94; ATF 115 II 484, JT 1990 I 210; PIERRE TERCIER, p. 176, N. 860 et seq.
\textsuperscript{59} PIERRE TERCIER, p. 176, N. 866 et seq.
If performance does not occur, art. 107 §2 CO provides for a variety of consequences. Indeed, the creditor may (i) demand that the obligation be carried out (specific performance); he will still be entitled to claim damages for late performance ("first option"); (ii) provided he declares so immediately, the creditor may waive his right to require performance and either (a) claim damages for non-performance, i.e., positive interest ("second option"), or (b) depart from the contract, i.e. waive his right to claim performance and demand so-called negative interest ("third option")\(^{60}\). In Swiss law, positive interest is defined as the interest that the claimant had in the implementation of the contract; negative interest being, simply said, that which the claimant had in not concluding the contract\(^{61}\).

Occasionally, the parties may expressly provide for liability in the event of breach and for the consequences thereof, for example in the form of conventional penalties or liquidated damages or, on the contrary, for exclusion thereof\(^{62}\). Where they have not, the practical consequences of contractual liability might vary considerably and will therefore be assessed on a case by case basis, which might prove to be extremely difficult.

4.3.1.1. Specific Performance

To the extent all or part of a letter of intent qualifies as a contract, specific performance can, as a matter of principle, be claimed. A non-controversial example lies in a clause which provides a duty to hand over certain documents obtained during the due diligence. Apart from these clearcut instances, ordering specific performance of M&A deals based on plain letters of intent should only be admitted restrictively in view of the nature of this type of transaction\(^{63}\).

Whenever a letter of intent qualifies as a promise to contract, not only will those provisions relating to the negotiation of the final contract be enforceable, but, in some cases, so will also be the conclusion of the final contract itself. As seen above, in normal cases the Swiss Federal Court is reluctant to order a possible enforcement of the conclusion of a final contract based on a plain promise to contract; considering the peculiarities of M&A transactions, this is therefore a fortiori be a controversial issue in M&A.

It is true that, in 1971, the Swiss Federal Court ruled that, in principle, the promise to contract entitled the claimant (buyer) not only to an indemnity but also to the specific performance (Realeurfüllung) of the prospected contract. In the case in question, the final contract however consisted in the sale of land, whereby specific performance enabled the claimant (buyer) to obtain registration of the land in its name\(^{64}\). The enforcement of

\(^{60}\) See also art. 109 CO.
\(^{61}\) On positive and negative damages, see PIERRE TERCER, p. 220, N. 1103 and 1104. On contractual liability generally, see PIERRE TERCER, p. 230 et seq., N. 1163 to 1225.
\(^{62}\) Conventional liability may namely provide for the right to depart from the negotiation anytime free of any liability for damages.
\(^{63}\) See herein, HENRY PETER, M&A transactions: process and possible disputes, § 3.1.4.
\(^{64}\) ATF 97 II 48 (1971), Odier v. Delavy.
the promise to contract was therefore relatively straightforward. Whether the Court would have issued the same ruling in a case concerning an M&A deal is questionable.

In 1976, the Swiss Federal Court admitted, in its entirety, the claim of the potential sellers for payment of the penalties provided for in the draft of an M&A agreement. In this case, the parties had signed a promise to contract and drafted the final sale contract but had abstained from signing it. The deal sought to merge two stock companies into a holding. The Court ruled that the promise to contract entitled the parties to require performance of the draft agreement. Since the claimants (sellers) did not request specific performance, the Court, regretfully, did not have the chance to rule on the implementation of the merger itself.

As noted above, in 1977 the Federal Court stated that since the relevant promise to a contract contained all essentialiae, it amounted to an enforceable final contract. The dispute concerned the registration of a sale in the real estate property register, which was possible on the basis of the promise to contract. This position has been confirmed several times since.

The impact of this case law on a letter of intent qualifying as a promise to contract appears to be that, if circumstances allow, it can bind the parties to both the conclusion and the performance of the final contract. It should not, however, be overlooked that M&A transactions are sometimes highly complex and require much more than the plain assignment of shares or assets. Accordingly, ordering specific performance in this field can prove inappropriate or even totally unrealistic. It could probably be sustained that, in most cases, in view of the very nature of the deal, the right to claim specific performance based on a letter of intent has been implicitly waived.

Where - or to the extent that - the letter of intent is only concerned with the negotiations, one can hardly identify a provision capable, in practice, of being enforced against the will of the other party.

4.3.1.2 Positive Interest

Further issues arise in the context of the second option of art. 107 §2 CO where the relevant party waives its right to obtain specific performance but claims damages for non-performance.

Beyond damnum emergens however, it will often be difficult to assess the lucrum cessans. In this respect, suffice it to think of the difficulties in estimating the earning capacity of an individual in the event of permanent injuries or death, to convince oneself that a similar estimate in the case of an unsuccessful, complex merger or acquisition

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66 See supra § 3.2.
67 ATF 103 III 97 (1977), Blum v. Bancolin, at 105-7.
68 ATF 118 II 32 (1992) = JdT 1993 I 387. See also ATF 127 III 248 (2002) (essentialiae missing; no contract); and ATF 129 III 264 (2003) (promise to sell an immovable amounting to a conditional sale, whereas the condition was ultimately not met).
69 See RALF SCHLOSSER, p. 352; ERNST A. KRAMER, ad art. 22 CO, N. 67.
would necessarily be speculative. However, this does not mean that positive interest should not be granted. Art. 42 § 2 CO will often be the key provision in such cases.

In any event, these difficulties appear to militate strongly in favour of conventional penalties.  

4.3.1.3. Negative Interest

In the context of the third option, the creditor will claim the damage it would not have incurred if the negotiations had never taken place. In practice, he will claim not only the financial and other costs resulting from non-performance, but also all other costs connected to the negotiation from its inception, namely all legal and advisors’ fees, as well as the time and costs incurred by the relevant party’s own structure, etc. Whilst damages relating to the promise to contract or an actual contract do not fundamentally differ from those relating to negotiation only, they can be expected to be higher, since the commitment to conclude possibly involved more extensive expenses.

Beyond these costs, it is worth mentioning that the seller might have a claim against the potential buyer because the latter induced the former to irremediably decline the offer of another potential buyer or, generally, because he has lost other opportunities. However, proof of this kind of prejudice will generally be difficult to adduce.

4.3.1.4. Partnership

Should it be considered that a letter of intent gives rise to a partnership, as has been suggested it is not art. 97ss CO which apply but rather art. 530ss CO. In several respects answers to the same issues might then be different. There shall, for instance, be a duty of loyalty (art 536 CO). There shall also be a right to terminate (i.e. not to implement the transaction) if good reasons to do so arise (art. 545 § 2 CO). Finally, rather than the traditional issue of damages which arises in case of synallagmatic agreements, the main issue in case of partnership is to know how the relationship between the parties will be "liquidated" should the partnership be dissolved. Should, for instance, the parties have started to set up a contractual joint venture without being able to complete it, irrespective of any breach, both parties will have a claim in respect of the surplus (profit) generated by the joint project, if any (art. 549 § 1 CO). This line of thinking might be insidious; however, knowing that, in case losses result from the common project, which might easily occur in the initial phase, these, as well, shall be borne by both parties, pursuant to art. 549 § 2 CO, unless a different solution has been expressly or implicitly provided for.

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70 See herein GEORG VON SEGESSER, Arbitrating pre-closing disputes in merger and acquisition transaction, § 6.3.5; HENRY PETER, M&A transactions: process and possible disputes, § 3.2.3; PETER FORTSCHOSER, Schweizerisches Aktienrecht, Zürich 1981, § 9, N. 19; ATF 102 ll 420 = JT 1978 1230, § 4.  
72 See supra § 3.1.
4.3.2. Culpa in Contrahendo

Parties to a letter of intent are also liable if they breach their pre-contractual obligations. Unlike contractual liability, culpa in contrahendo entitles the parties to negative interest only.\(^{73}\)

4.3.3. Statute of Limitations

Claims based on contractual liability are subject to the ordinary ten-year statute of limitations pursuant to art. 127 CO.

Pre-contractual liability is of a mixed nature, i.e. partly contractual and partly extra-contractual.\(^{74}\) The Swiss Federal Court has ruled, however, that as far as the statute of limitations is concerned, art. 60 CO shall apply,\(^{75}\) the timelimit being therefore one year.

5. Conclusion

Hence the nature of the letter of intent is, in many ways, ambiguous. This derives from the fact that (i) it almost always combines binding and non-binding clauses and (ii) it in any event triggers at least behavioural obligations. As such, it therefore does not enter into any particular category, as any determination of its nature is extensively fact driven. It often lies somewhere between legally inexistent and legally binding instruments. Moreover, as put by Fontaine, anarchy in terminology still seems to be prevalent in this field.\(^{76}\)

Among the remedies theoretically available in case of non-performance, specific performance can be envisaged only in exceptional circumstances.\(^{77}\) Whenever a letter of intent produces binding effects, positive damages might be claimed. In all other cases, in view of the pre-contractual nature of its effects, only negative interests may be sought.

\(^{73}\) ATF 105 II 75 (1979), 81 = JdT 1980 I 67.
\(^{74}\) See Rudolf Tschäni, p. 18, N. 7.
\(^{75}\) Ibidem.
\(^{76}\) Marcel Fontaine, p. 89.
\(^{77}\) See therein, Henry Peter, M & A transactions: process and possible disputes, § 3.1.4.