Letters of Intent – Unexpectedly Binding?

SPRING 2010

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In the recent case, *Wallace v. Allen* (2009 ONCA 36), the Ontario Court of Appeal, overturning an earlier decision by the Ontario Superior Court of Justice, held that a letter of intent with respect to a purchase of a business created a binding share purchase agreement.

In August 2004, Allen let it be known to his neighbor Wallace that he was intending to sell his business (the "Business"). In the following weeks, Allen and Wallace negotiated a letter of intent for the share purchase and sale of his companies (the "LOI"). Both parties signed this LOI on September 24, 2004 after two initial drafts of the LOI were presented by Wallace to Allen but were rejected by Allen because "there remained too many things up in the air". Both parties acknowledged that all of the terms they considered necessary or essential to the transaction were agreed upon that day and included in the LOI.

The LOI was forwarded to the parties' respective legal counsel to prepare the formal share purchase agreement. In the interim Wallace attended at the Business daily to learn the business. Wallace also persuaded a friend to leave secure employment and begin work at the Business in October 2004, as Wallace believed he had a firm deal. Further, Wallace purchased a home in Orillia for his son, who was also going to be involved in the Business.

Allen, for his part, announced within two weeks of signing the LOI at a special employees meeting that he had sold the Business, that the "deal was solid" and announced his impending retirement. Wallace spoke at this meeting and later at the company Christmas party, where he was introduced by Allen as the "new owner" of the Business, as he had on numerous occasions to employees, customers and business contacts throughout the fall.

A December 9, 2004 meeting was held to finalize the terms of the share purchase agreement and December 29, 2004 was set as the closing date. There was no "time of the essence" clause in the share purchase agreement.

On the closing date, Allen attended the signing but Wallace was on holidays in Florida, a vacation that Allen was aware of and had encouraged. When it was determined that the closing documentation had not been signed by Wallace prior to his vacation, even though the funds to close the transaction were with Wallace's legal counsel, Allen refused to close the transaction.

In its review of this case, the Court of Appeal held that the LOI plainly expressed an intention on the part of the parties to be bound by the terms of the LOI, which terms were to be incorporated into a more formal document. The Court focussed on two clauses:

> "It is also agreed by the parties that there will be much legal work to be done upon acceptance by both sides and that the wording of this agreement may alter somewhat"
> **and**
> "This letter of intent must be reduced into a binding agreement of purchase and sale by the parties within the next 40 days"

The Court held that both clauses contemplated that it is the wording of "this" agreement (not some other agreement) that "may alter somewhat" and "must be reduced into a binding agreement of purchase and sale" – and only the wording, not the substance, would be amended.

Further evidence that the parties intended to be bound upon the signing of the LOI were the use of phrases such as "it is agreed", "upon acceptance" and "this agreement" and that Allen had rejected earlier versions of the LOI only to sign this one.

The Court also determined that the course of conduct of the parties after signing the LOI justified its decision. The daily of attendance of Wallace at the Business, the inclusion of Wallace's friend and son into the Business, the deposit of the funds to close into Wallace's legal counsel's trust account, Allen's announcement of his retirement, Allen's introduction of Wallace as the new owner, Allen's knowledge of Wallace's vacation, both parties conducting their affairs as if the deal was completed and that time was not of the essence, were all used as grounds to substantiate the Court's decision.

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In making its award, the Court opted to award monetary damages instead of ordering that the deal should be completed and the Business transferred. Wallace acquired and operated businesses for a living and this business was not singularly unique to warrant specific performance. In addition, four years had passed since the scheduled closing date, further supporting the decision to award damages.

Parties to a letter of intent should be aware that a letter of intent is potentially a legally binding agreement, even if the letter contemplates a later “formal” agreement. Very clear wording is required to overcome the powerful combination of written statements of intention and conduct supporting those intentions.