

Real Property Seminar
Baltimore Culinary Institute

OUTLINE FOR

WHEN IS A LETTER OF INTENT BINDING? A REAL (RECENTLY DECIDED) CASE STUDY

Presenter: Douglas M. Bregman, Esq.

1. Introduction of Lawsuit.
2. Explain Contents of Letter of Intent that was the subject of Litigation
3. Examine Language in the Letter of Intent.
4. Review the Plaintiff's Arguments and Law.
5. Review the Defendant's Arguments and Law.
6. Explain and Evaluate the Judge's Opinion

WHEN IS A LETTER OF INTENT BINDING? **A REAL (RECENTLY DECIDED) CASE STUDY**

Presenter: Douglas M. Bregman, Esq.

The Parties:

The developer is ABC Development, Inc. (“the Developer”)¹. ABC Development, Inc. is in the business of developing, redeveloping, acquiring and managing shopping centers, hotels, office buildings, condominiums and luxury apartment communities. ABC Development intends to form a single purpose limited liability company (LLC) to purchase land and construct improvements. ABC Development, Inc. will be the sole member of the LLC. The property owner is Bushville Area Metropolitan Transit Authority (“BAMTA”).

The Project:

The project is a public-private, mixed-use joint development project to be comprised of an office building, a hotel, and luxury apartment units, with associated parking, as well as a new transit station for BAMTA. The project is to be constructed in two phases: the residential apartment units and associated parking first and the office building and hotel component second. A new parking garage will also be constructed to be used as parking for the commercial phase, as well as general public parking.

The Letter of Intent:

Prior to development, the parties executed a Joint Development Term Sheet (the “Term Sheet”). The Term Sheet, which is fifty-seven (57) pages with dozens of attachments, included the following provisions:

The Parties’ Roles: The Developer is to construct the residential and commercial components. BAMTA is to construct the parking facility, which will include approximately 1,200 parking spaces, a minimum of 540 of which will be leased to the Developer for the Developer’s use in connection solely to the Commercial Phase. BAMTA, at its sole cost and expense, will pay all design and construction costs for the parking facility. Upon completion of construction of the parking facility, BAMTA will operate and maintain the facility.

¹ The real case was entitled *Avalon Bay Communities, Inc. v. Washington Metropolitan Area Transit Authority*. The case was filed in the United States District Court for the District of Maryland (Southern Division); Civil Action No. RWT-03-2963. The facts in that case are modestly different from the facts recited in this Case Study, only to make the presentation more pointed.

Parking Facilities: The Developer and BAMTA will enter into a lease agreement for a minimum of 540 parking spaces in the new parking facility ("Leased Spaces"). The number of Leased Spaces will be adjusted proportionately to reflect any increase or decrease in the approved density in the Commercial Phase above or below 300,000 gross feet, at a rate of 1.8 spaces per 1,000 gross square feet of commercial development. The commercial parking lease will be for an initial term of fifty (50) years, with the option to extend for a term of forty-nine (49) years. The monthly rental due will be at the rate established for other monthly reserved parking spaces in fully-utilized parking facilities in the county. The Developer will construct a parking structure and surface parking to serve the Residential Phase.

Security Deposit: A \$250,000 deposit was paid when the Term Sheet was signed. Also, a \$250,000 Security Deposit will be paid by the Developer to BAMTA at the execution of the Sales Agreement.

Purchase Price: The purchase price for the residential land is \$3.9 million, subject to adjustment. The residential purchase price will be increased or decreased to reflect changes between the proposed density and the density approved for development. The proposed residential density is 300 dwelling units. Adjustments shall be made using the rate of \$32,000 per approved dwelling unit. The purchase price for the commercial land is \$5,500,000. The commercial purchase price will be increased or decreased to reflect changes between the proposed density and that approved for development. Adjustment will be made at the rate of \$4.00 per approved gross square foot for the office building and \$32,000 per additional hotel room. If the Developer is unable to obtain governmental approval for not more than eighty-five percent (85%) of the total proposed density for the Commercial Phase, then the Developer or BAMTA may cancel the purchase of the commercial land. The total purchase price is \$9.4 million, subject to the adjustments provided.

Settlement: The residential land settlement will occur within twenty-four (24) months of execution of the Sales Agreement. If BAMTA does not complete construction of the new parking facility within twenty-four (24) months of execution of the Sales Agreement, the twenty-four (24) month period referred to above will be extended on a day-to-day basis until construction of the parking facility is completed. The commercial land settlement will occur within thirty-six (36) months of the Sales Agreement execution date.

By its terms, the Term Sheet shall have no binding effect on the parties except as may be provided under common law. Any expenditure undertaken by either party is at their own risk. This Term Sheet contemplated the future negotiation of outstanding material terms and the completion of further material documentation. However, if and to the extent that any provision in this fifty-seven (57) page Term Sheet was different from the Final Offer, such provision of this Term Sheet reflected the understanding of the Parties.

In the Term Sheet, each of the parties was required to negotiate diligently and in good faith to finalize the Sales Agreement, and the other agreements referred to in it, in a manner consistent with the terms and conditions.

In addition to the provisions above, the Term Sheet also contained many other sections including these covering Agreements (right of entry, operating, and sales), Contingencies, Project Schedule, Option Fees, Conditions for Closing, Insurance and Indemnification, Performance and Payment, Default Provisions, Dispute Resolution, and Representations and Warranties.

The Dispute

After execution of the Term Sheet, the parties participated in negotiations to finalize the Sales Agreement and other documents contemplated by the parties. As the parties were unable to agree on terms for the requisite agreements after many months of negotiation, BAMTA sent a letter to the Developer, terminating the selection of the Developer as the joint development partner in the project. The Developer then filed suit against BAMTA for breach of the Term Sheet.

In the Developer's Complaint, it based its conclusion that the Term Sheet is a valid and binding contract on the language in the Term Sheet that "if and to the extent that any provision in this Term Sheet is different from the Final Offer, such provision of this Term Sheet reflects the understanding of the parties," as well as the language requiring the parties "to negotiate diligently and in good faith to finalize the Sales Agreement." Because the terms BAMTA was trying to get during negotiation of the Sales Agreement were arguably different from those in the Term Sheet, the Developer claimed BAMTA breached the Term Sheet under the above-quoted provision. The Developer also alleged that because BAMTA offered terms different from those contained in the Term Sheet, BAMTA was breaching its obligation under the Term Sheet to negotiate in good faith.

The Subplot

The value of the real estate was significantly greater than the Term Sheet price. In fact, BAMTA was offered \$18 million by another developer.

Legal Analysis

1. The Case Law Analysis.

Parties to complex transactions often attempt to negotiate more efficiently by using a preliminary non-binding document, sometimes referred to as a "letter of intent," to develop a framework for further negotiations, which ideally will lead to the memorialization and execution of a final, binding agreement. *See Paramount Brokers, Inc. v. Digital River, Inc.*, 126 F. Supp.2d 939, 946-47 (D.Md. 2000); *see also Phoenix Mutual Life Ins. Co. v. Shady Grove Plaza Limited Partnership*, 764 F.Supp. 1181, 1186-87 (D.Md. 1990). While letters of intent, and similar documents, are not binding, the "expression of tentative intentions of the parties" evident in such documents are helpful in providing an initial framework to negotiate. *See TecArt Indus. Inc. v. Nat'l. Graphics, Inc.*, 198 F. Supp.2d 719, 726 (D.Md. 2002) (citing *Phoenix Mutual Life Ins. Co.*, 764 F.Supp. at 1187); *see also Burbach Broadcasting Co. of Delaware v. Elkins Radio Corp.*, 278 F.3d 401, 406-407 (4th Cir. 2002) (citing *A/S Apothekernes Laboratorium v. I.M.C. Chemical Group, Inc.*, 873 F.2d 155, 158 (7th Cir. 1989)). These preliminary non-binding

agreements can take many different forms and have a wide range of labels. *See Burbach Broadcasting Co.*, 278 F.3d at 406-407 (noting that such labels might include "letters of intent" and "preliminary agreement"). However, these documents share a crucial common element -- they are expressions of future intentions and are not binding upon the parties. As these documents require future action, including negotiation, memorialization, and execution of a final document or documents, and the parties do not intend to be bound by any terms that might be included in the initial document, these preliminary documents are mere "evidence of preliminary negotiation or an agreement to enter into a binding contract in the future," which, hornbook law informs us, "does not alone constitute a contract." *Channel Home Centers v. Grossman*, 795 F.2d 291, 298 (3d Cir. 1986) (citing RESTATEMENT (SECOND) OF CONTRACTS § 26 (1979)).

As stated in *Paramount Brokers, Inc.*, "[l]etters of intent and negotiations ordinarily do not constitute binding contracts and will not be enforced by the courts." 126 F.Supp.2d at 945. This is because, in part, "the financial community does not regard [a letter of intent or term sheet] as a binding agreement, but rather, an expression of tentative intentions of the parties." *Abt Associates, Inc. v. JHPIEGO Corp.*, 104 F.Supp.2d 523, 531 (D.Md. 2000) (quoting *Dunhill Securities Corp. v. Microthermal Applications, Inc.*, 308 F.Supp. 195, 198 (S.D.N.Y. 1969)). In a number of cases over the last few years, courts have been presented with the question of whether preliminary documents executed by the parties are merely letters of intent or, rather, binding agreements. *See Tec Art Industries, Inc.*, 198 F.Supp.2d 719 (D.Md. 2002); *Abt Assocs.*, *supra*; *Paramount Brokers*, *supra*; *Phoenix Mutual Life Ins. Co.*, *supra*, *affd* 937 F.2d 603 (4th Cir. 1991). In each of the aforementioned cases, courts have found that no binding agreement was ever reached between the parties. In coming to this conclusion, some courts examined the New York case of *Teachers Ins. and Annuity Ass'n v. Tribune Co.*, 670 F.Supp. 491 (S.D.N.Y. 1987), and adopted the five factors set forth in that case for determining whether the parties intended to be bound by a letter of intent. These are: "(1) the language of the agreement; (2) the context of the negotiations; (3) the existence of open terms; (4) partial performance; and (5) the custom of such transactions." *Abt*, 104 F.Supp.2d at 531 (citing *Teachers Ins. and Annuity Ass'n v. Tribune Co.*, 670 F.Supp. 491 (S.D.N.Y. 1987)).

In *TecArt Indus.*, the parties entered into negotiations for the purchase by the plaintiff of a division of the defendant's company. These negotiations eventually led to a letter agreement, which the plaintiff characterized as a binding and enforceable contract. The defendant asserted that the document in question was no more than a letter of intent and that, because no formal purchase agreement was ever executed, the defendant was not liable to the plaintiff for breach of contract. *See TecArt*, 198 F.Supp.2d at 720. The court agreed with the defendant and found that no binding and enforceable agreement was ever reached by the parties. *See id.* at 725. The court examined the five factors set out in *Teachers*, and found that "the parties intended that several additional documents would have to be agreed upon and executed by them before a binding and enforceable contract existed." *Id.* In so finding, this court noted that "there is a strong presumption against finding a binding agreement when the parties expressly contemplated the future preparation of and the execution of a formal contract document." *Id.* at 726 (citing *Phoenix*, 734 F.Supp. at 1188 and *Teachers*, 670 F.Supp. at 499).

In *Paramount*, the plaintiff alleged that the defendant executed a "Letter of Interest" in which the defendant agreed to retain the plaintiff as its exclusive representative for purposes of developing and maintaining a vendor relationship between the defendant and Wal-Mart Stores, Inc. *See Paramount*, 126 F.Supp.2d at 941. Applying the five factors set forth in the *Teachers* case, the court concluded, as a matter of law, that the parties did not intend to be bound until a formal written agreement was executed. *See id.* at 947. In coming to this conclusion, the court looked at the language of the Letter of Interest, which expressly stated that the parties' preliminary understanding was subject to reaching a final agreement. *See id.* at 942.

In *Abt*, the plaintiff alleged that the defendant promised that the plaintiff would have a major role in the technical direction and oversight of a program awarded to the defendant by the United States Agency for International Development, and that, after the defendant received the award, it entirely excluded the plaintiff from the program. *See Abt*, 104 F.Supp.2d at 525-26. The plaintiff sought recovery for breach of contract, alleging that it had entered into a binding contract with the defendant. The plaintiff alleged that the material terms of the contract were articulated in discussions, correspondence and other documents prior to the award of the final agreement. *See id.* at 529. Applying the five factors set forth in *Teachers*, the court concluded in *Abt*, that, as a matter of law, no binding and enforceable agreement was ever reached between the parties, and the court granted summary judgment in favor of the defendant. *See id.* at 532. In so ruling the court noted that "[f]or a letter of intent to be binding on the parties, it must expressly indicate the parties' intention to be bound by the document." *Id.*

In *Phoenix*, the parties entered into negotiations to create a joint venture to construct an office building in Montgomery County, Maryland. When the negotiations failed to result in the execution of a final agreement between the parties, the plaintiff filed suit claiming that a binding and enforceable contract between the parties had nonetheless been formed. *The Phoenix* Court granted the defendants' motion for summary judgment, finding that, as a matter of law, no agreement was ever reached between the parties. The court stated:

It was hardly unfair under the circumstances here for defendants to discontinue negotiations and decline to enter into a partnership agreement with plaintiff. The parties had agreed in writing that there would be no deal at all unless a mutually acceptable partnership agreement was executed. When plaintiff refused to accept terms of the agreement proposed by defendants, no mutually acceptable contract was possible. Defendants acted fairly and reasonably when they decided that their economic interests would best be served by terminating the discussions. Defendants did not, as plaintiff has argued, go too far down the road to call off the deal with impunity, since defendants had the right to call off the deal at any time before a formal agreement was executed.

Phoenix, 734 F.Supp. at 1186.

In *Burbach Broadcasting Co. v. Elkins Radio Corp.*, 278 F.3d 401, 406-07 (4th Cir. 2002), the court noted:

"it is difficult to generalize about the legal effect of preliminary agreements. They can cover a broad scope of agreements, ranging in innumerable forms and variations from letters of intent ... to firm binding commitments which, notwithstanding a need for a more detailed documentation of agreement, can bind the parties to adhere in good faith to the deal that has been agreed."

The court further observed that "[w]hile bare-boned 'agreements to agree' are not binding, courts have recognized two kinds of preliminary agreements that are binding and enforceable." *Id.* at 407.

The Burbach Court referred to the "well-reasoned and often cited decision" of *Teachers* in which two distinct types of binding preliminary contracts were discussed. The first, "Type I," exists where "the parties have reached complete agreement (including the agreement to be bound) on all issues perceived to

require negotiation. "Such an agreement is preliminary only in form - only in the sense that the parties desire a more elaborate formalization of the agreement." *Id.* at 498. The court next examined the "Type II" agreement and said:

The second and different sort of preliminary binding agreement is one that expresses mutual commitment to a contract on agreed major terms, while recognizing the existence of open terms that remain to be negotiated. Although the existence of open terms generally suggests that binding agreement has not been reached, that is not necessarily so. For the parties can bind themselves to a concededly incomplete agreement in the sense that they accept a mutual commitment to negotiate together in good faith in an effort to reach final agreement within the scope that has been settled in the preliminary agreement. To differentiate this sort of preliminary agreement from the first, it might be referred to as a binding preliminary commitment.

Id. (emphasis added); see also *Richbell Info. Svcs. v. Juniper Partners*, 309 A.D.2d 288, 298, 765 N.Y.S.2d 575, 584 (N.Y. App. Div. 2003) ("[e]ven where the parties acknowledge that they intend to hammer out details of an agreement subsequently, a preliminary agreement may be binding"). The court added that "[t]he second type - the binding preliminary commitment - does not commit the parties to their ultimate contractual objective but rather to the obligation within the agreed framework." *Id.* The court then went on to discuss the applicable remedies:

In the first type, a party may lawfully demand performance of the transaction even if no further steps have been taken following the making of the 'preliminary' agreement. In the second type, he may not. What he may demand, however, is that his counterpart negotiate the open terms in good faith toward a final contract incorporating the agreed terms. This obligation does not guarantee that the final contract will be concluded The obligation, does, however, bar a party from renouncing the deal, abandoning the negotiations, or insisting on conditions that do not conform to the preliminary agreement.

Id. (emphasis added); *A/S Apothekernes Lab. for Specialpraeparater v. I.M.C. Chemical Group, Inc.*, 873 F.2d 155 (7th Cir. 1989) (quoting the above-cited language with approval); see also *Burbach Broadcasting Co.*, 278 F.3d at 408 n.6 ("[a] Type II preliminary agreement prevents parties from arbitrarily abandoning negotiations, and therefore provides an assurance that a deal will falter only over a genuine disagreement").

In some circumstances, the parties' intention is to enter into an agreement to negotiate towards a final contract, but in the letter of intent to form a partially binding agreement as to certain terms, to be effective immediately (such as confidentiality or to be included in the final contract. The Michigan Supreme Court quoted Corbin when stating, "We must not jump too readily to the conclusion that a contract has not been made from the fact of apparent incompleteness. People do business in a very formal fashion, using abbreviated and elliptical language. A transaction is complete when the parties mean it to be complete." *Opdyke Inv. V. Norris Grain Co.*, 320 N.W. 2d 836, 838 (Mich. 1982) (quoting 1 Corbin, Contracts, § 29, pp. 86-88). Under this view, does the provision in the Term Sheet providing that "if and to the extent that any provision in this Term Sheet is different from the Final Offer, such provision of this Term Sheet reflects the understanding of the Parties" create a binding contract as the Developer claims?

