

## insights

TYPES NOT MAPPED YET July 30, 2015 | TTR not mapped yet | Jeffrey N. Brown

# LOIs are nothing to LOL about: A primer on letters of intent

Letters of Intent can be minefields. On the one hand, business people want to use them to tie up a deal. On the other, they don't want to be bound by them if they want to walk away. As one court explained, "It is a common commercial practice for two negotiating parties to sign a letter of intent or an agreement in principle, signaling that they have come to a tentative agreement on the general outlines of a deal without having nailed down all of the details. Not infrequently, the negotiations that follow the execution of this document break down, prompting the disappointed party to sue on the theory that the preliminary document is binding."

How do the courts decide whether these LOIs are enforceable? While courts across the country interpret LOIs in different ways, there are some trends that are generally consistent.

Subjective belief doesn't mean anything. Instead, look at the language of the LOI. Does the LOI state that there will be no binding contract unless and until the parties sign a formal written contract? That type of provision has a better chance of allowing the parties to walk away, as opposed to an LOI that says the parties intend to "reduce the informal writing to a more formal one." In the latter case, the court may find that there was still an enforceable agreement, even though the parties wanted to make it prettier and longer later on. If you want to avoid enforcement, use protection, like a disclaimer.

### Partially enforceable

What if the parties want some of the LOI to be enforceable, even if there is no final overall agreement? That is generally allowable; the parties may agree that there is no enforceable purchase and sale agreement or lease agreement until they have executed a formal, written agreement, but still use the LOI to enforce certain rights and duties that flow from their negotiation process, such as:

- **Confidentiality/Non-Disclosure:** The parties can include a binding requirement in the LOI that confidential information provided by the parties is not to be disclosed to third parties and is to be utilized only for the purpose of evaluating the pending deal. The provision may also require that if the deal is not closed, the confidential materials (and all copies) must be returned to the party who provided the information.
- **Non-Circumvention:** The LOI may preclude a party from competing with the other party on the project and certainly stop that party from using the confidential material provided by the party for any other purpose.
- **Exclusive Negotiation:** To promote focus, the parties can include a provision which requires that with respect to the particular project, they can only negotiate among themselves for a period of time.

### Expiration of LOIs

Once the LOI has expired, there is no further obligation on the parties to negotiate. In California, courts have held that the implied covenant of good faith and fair dealing requires that parties must negotiate in good faith and that if they do not, then the party who did not do so may be responsible for some types of damages. A deadline for completing negotiations puts an end to any potential claim by a party that the other is not acting in good faith. It also provides support for the argument that once that deadline passes, there is no enforceable agreement in the absence of a formal written agreement. But, again, be careful. Don't let your conduct be used as evidence by the other party that the parties really did come to agreement. In one California case for example, the court held that an LOI created an enforceable sublease because, in part, the prospective subtenant entered into possession with the consent of the sublessor. If the parties had not intended to create a sublease, why would the prospective subtenant be allowed to take possession?



What's the moral of the story? Real estate parties must be careful in drafting LOIs if they want to avoid having a judge later hold that instead of a precursor to an agreement, the LOI became an enforceable agreement. A better option? Have your counsel review the terms before the LOI is signed. It is much easier to make changes before the LOI is signed than after the parties are heading toward litigation.

*Jeff Brown is a partner in the firm's litigation department with a practice that focuses on real estate. You can reach him at (310) 282-9418 or [jbrown@thompsoncoburn.com](mailto:jbrown@thompsoncoburn.com).*

#### authorsTest

jeffrey

Jeffrey N. Brown