LETTERS OF INTENT

I. INTRODUCTION

Many real estate developers, attorneys and brokers believe that letters of intent are a useful tool for flushing out the business terms of a transaction before investing the time and expense in negotiating a lease or purchase agreement. Other real estate practitioners believe that letters of intent are, at best, a waste of time and, at worst, an invitation for litigation. This article will discuss both the advantages and disadvantages of using letters of intent, and hopefully, provide some parameters for their use.

II. DISCUSSION

The key issue with a letter of intent is whether such letter of intent will be deemed to be binding or not. What if the parties have entered into a letter of intent, but are unable to agree on the terms of the subsequent purchase agreement or lease? Can one party sue to enforce the terms of a letter of intent?

As is so often the case in the law, the answer to this question is "it depends." The Michigan Supreme Court has held, as have courts elsewhere, that a contract to make a contract may be enforceable. *Opdyke Inv Co v Norris Grain Co*, 413 Mich 354 (1982). In determining whether a letter of intent is binding, the court will look at the intent of the parties. The intent will be discerned from the language of the letter of intent itself, as well as the conduct of the parties.

A couple of key point should be kept in mind. First, in order to be binding, the letter of intent must be deemed to contain the "essential terms to be incorporated into the final contract." Second, if the letter of intent involves an agreement to sell real estate or lease for more than one year, it must be in writing, signed by the parties. In an effort to prevent someone from later claiming that the letter of intent was intended as a binding contract, some practitioners intentionally omit key terms of the contract and/or do not have the parties sign the letter of intent.

More often, practitioners will include a clause in the letter of intent expressly stating that it is for purposes of discussion only and is nonbinding. An example of such a provision is as follows:

> This letter constitutes only a statement of the parties' present intention and is not to be construed as and shall not be a binding contract enforceable against either party. Neither party shall be liable to the other for any fees, costs or expenses incurred by reason of the pursuit of the intent of this letter. Any expenditure incurred by either party pursuant to or on the basis of this letter is undertaken at that party's sole risk. Both parties recognize and agree that they shall be bound only by the fully-executed formal documents contemplated by this letter. Either party may unilaterally decide to terminate negotiations without any liability to the other party.

Be careful, however, that this language is NOT contradicted by other language in the letter of intent – for example: (a) "the parties are obligated to negotiate in good faith"; or (b) "the parties agree to enter into a definitive contract within 10 days of the date hereof". Opponents of letters of intent would likely argue that it makes little sense to spend time and money negotiating the terms of a nonbinding letter of intent – and that this time would be better served working on the agreement itself. Proponents would likely counter that it makes no sense to try to work out, for example, due diligence issues, if the parties cannot even agree on the purchase price.

The more complicated the underlying transaction, the more useful a letter of intent may be. If a buyer wants to purchase a vacant parcel of land for cash, the parties should probably spend their time and resources negotiating the terms of the purchase agreement itself. If, on the other hand, a buyer wants to purchase the assets of an ongoing business, or lease a portion of a shopping mall, a nonbinding letter of intent may be a useful tool for flushing out potential deal-breaking issues early in the negotiation process.

Nonbinding letters of intent may also be used by a potential buyer or tenant to prevent the seller/landlord from negotiating with other parties while the parties try to put together a deal. Such a letter of intent would need to be carefully drafted to make certain that while the exclusive dealing provision was intended to be binding, the underlying letter of intent was not.

Other potential binding obligations in a nonbinding letter of intent may include: a confidentiality clause, a provision requiring the buyer to indemnify the seller for any damage to persons or property arising out of the buyer's inspection of the property, and/or an allocation of expenses incurred during the due diligence process. Again, however, the letter of intent should be carefully drafted so as to differentiate those provisions that the parties intend to be binding, from the balance of the terms of the letter of intent.

Letters of intent should have an "end date." A nonbinding letter of intent could provide, for example, that it will automatically terminate if the parties do not enter into a definitive contract within three (3) weeks of the date hereof. Again, however, it is important to carefully draft this language so as not to suggest that the letter of intent should be binding.

Finally, it is quite possible that the final document – albeit a purchase agreement, lease or other contract – may contain provisions which are different from those originally anticipated in the letter of intent. Because of this, the final document should contain a merger clause so as to prevent one party from trying to resurrect a favorable term from the letter of intent. An example of such a provision is as follows:

> This agreement contains the entire agreement of the parties concerning the matters contained in this agreement and may not be altered, modified or changed in any manner except by a writing executed by the parties. No party is relying on any representations or promises other than those expressly set forth in this agreement. All prior agreements, discussions and negotiations have been and are merged and integrated into, and superseded by, this agreement.

III. CONCLUSION

Real estate practitioners should use letters of intent cautiously. A REALTOR® who takes it upon himself to draft a letter of intent on behalf of a client is incurring significant risk (and perhaps engaging in the unauthorized practice of law). A much better practice would be to prepare a (unsigned) term sheet, which can then be forwarded to the client's attorney to be used in preparing a letter of intent.