A letter of intent may be used to encapsulate the terms of the lease in an abbreviated manner. It is generally used to establish the key terms of a deal before the formal agreement is prepared and executed. Unfortunately, letters of intent are very often signed without attorney input.

If the lawyer is consulted, the first question to be considered in evaluating a letter of intent is “When are letters of intent binding?” This leads to the next question, that is, “For what purpose?” Are they binding for the purpose of creating an obligation to negotiate in good faith? Or are they binding as an agreement between the parties as to the terms and conditions of the transaction?

I do not propose to discuss the many cases on letters of intent that deal with those issues—for that, I recommend to you an excellent article by Thomas C. Homburger and James R. Schuler entitled “Letters of Intent—A Trap for the Unwary”. In that article, the authors determine that, depending on the jurisdiction, the answer may turn in part on the language in the letter of intent and in part on other evidence of the intent of the parties. In other words, even though there may be language in a letter of intent stating that it is not intended to bind the parties to an agreement until a final agreement is written up, executed, and delivered, the parties may in fact be bound. At the very least, a letter of intent

1. 37 Real Property, Probate & Trust J. 3, 509 (Fall 2002).
may create an obligation to negotiate in good faith, unless that is expressly negated in the document.

Brokers like letters of intent. First, but not necessarily foremost, the letter of intent may result in the entitlement to a commission, based on the broker having found a “ready, willing, and able” tenant or purchaser for his or her client’s space. More often, however, commissions are not really earned until a lease is signed, so we should not impute negative motives to brokers. No, brokers like letters of intent because they document the basic terms of the deal and facilitate the drafting of the lease or contract document.

Usually, letters of intent drafted by brokers contain language that negates the intent to create a binding agreement, but as noted above, it may not be entirely effective. Often, a broker representing a tenant will make a “request for proposal” (an RFP) to the landlord or its broker and receive a detailed response that will contain the business terms of the deal. Sometimes, the broker representing the tenant or buyer will make an “offer” setting forth the terms on which the tenant is willing to enter into the lease or the buyer is willing to enter into a contract. That offer may be “accepted” or may be subject to a “counteroffer.” I put the words in quotation marks because the offers, acceptances, and counteroffers are not really intended to be used in the context of creating a binding agreement, and they probably do not do so for several reasons. First, it is understood in the trade that it is not their purpose. More importantly, the broker does not usually have the authority to bind his client to a lease or contract. The actual parties do not customarily sign the papers being exchanged (unless, of course, there are no brokers involved). The problem really arises when the brokers take the terms that have been discussed, either orally, by RFP, or by offer and acceptance, and reduce them to writing in a letter of intent and ask the parties to sign them. Remember that, at this point in time, it is most likely that neither party has consulted its attorney.

Let us assume that I am consulted at that point in the process. Whether I represent the landlord or the tenant, my advice is, “Don’t sign!” By signing, the parties may create a binding agreement, even though important matters have not been dealt with, or have been dealt with in an imprecise manner.

Even if the letter of intent is accurate and contains all sorts of language about not creating a binding lease, there may still be problems. The problems may be made worse by making the letter of intent very detailed. I have
seen letters of intent that were extremely long and contained almost all of the terms of the agreement, using, in many instances, the very language contained in the lease proposed to be entered into. I do not believe that any amount of language that states that the letter of intent is not binding (except, perhaps, conditions such as approval by the party’s governing group, such as a board of directors of a corporation or members of a limited liability company) could keep that letter of intent from actually being enforced as the agreement between the parties.

What are some of the other problems with letters of intent?

While a major purpose of a letter of intent is to discourage each party from seeking a better deal before the current negotiations are wrapped up, some letters of intent actually require the landlord to cease marketing the property during negotiations. In representing a landlord, I strongly object to that provision (if I see it in advance) because it places what I deem to be intolerable burdens on that party. That party may have to incur the cost of removing large and expensive “For Rent” signs (and replacing them if the deal does not go through), but that is a minor matter compared to the requirement that the client turn away prospects when it does not have a firm deal. The problem is more serious when the tenant is to be afforded a period of time to conduct its due diligence or obtain zoning or permits, at the end of which period it may terminate the proposed deal, leaving the landlord with no alternative tenants.

In addition, the letter of intent may create an obligation to negotiate in good faith, and the refusal to agree to some important term may result in a claim (and litigation) that the party has failed to live up to that obligation. That puts particular pressure on the parties subsequently negotiating the lease, especially if, in the course of negotiation, issues are raised (and agreed to) that are inconsistent with the terms of the letter of intent. I experienced an example of this some years ago. A landlord client signed a letter of intent that committed the landlord to forego certain additional rent pass-throughs.2 The tenant asked for a larger build-out allowance

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2. “Pass-throughs” is shorthand for additional rent based on taxes and various operating expenses incurred by the landlord in connection with the property. They will be discussed at length below.
than was contemplated by the landlord (the issue was not clear in the letter of intent). The landlord granted the concession, but changed the lease to restore the pass-throughs and sent a red-lined copy of the lease to the tenant, highlighting the change in the pass-through language. The tenant signed the actual red-lined copy of the lease (implying that it had reviewed the changes since the prior draft), but then sued the landlord, claiming that the lease did not accurately reflect the agreement of the parties. To avoid protracted litigation and expense, the landlord settled the case.

Under the circumstances, what do I recommend?

1. The parties should not sign letters of intent. I mean that in two senses. The parties should avoid using letters of intent. They will, however, probably use them because they have some advantages. In that case, they should not sign them or give a written authorization to any third party to sign on their behalf; if they do, they may be deemed to have complied with the Statute of Frauds and be bound by the terms of the letter of intent without meaning to be.³ There are alternatives to letters of intent that are far less dangerous. For example, I recommend using a term sheet. It states, in essence, that “the following are the terms on which the parties propose to lease (or sell or purchase) such and such property” and then only the basic terms are set out. It is always wise to provide that it is not a binding agreement and to set out a date after which either party may terminate discussions without liability. It may even expressly negate an obligation to negotiate in good faith. Vagueness is the key. If the parties do not sign the letter of intent and the Statute of Frauds applies, the letter of intent does not bind the parties. There are two caveats. First, if a broker signs for a party, it should be clear that he is without written authority to bind the party. Second, beware of the Federal Electronic Signatures Act. A letter of intent sent via e-mail by a person who is

³. Most jurisdictions have enacted the “Statute of Frauds,” which provides that contracts for the sale of real estate and leases for a term in excess of one year must be signed by the party to be bound. In Illinois, the applicable provision of the Statute of Frauds is codified in 740 ILCS 80/2.
employed by one of the parties and who has authority to sign a lease may satisfy the requirements of that Act and bind the party.

2. If parties must use and sign a letter of intent, it should contain language negating the intent to create a binding agreement. If possible, conditions to the conclusion of a lease should be inserted. Examples of those conditions are board approval, tenant’s confirmation of the zoning or condition of the premises, in its discretion, or the landlord’s satisfaction, again in its discretion, with the tenant’s financial condition or its operation of its prior premises. If the obligation to negotiate in good faith is not negated, time periods should be provided for the delivery of the draft lease or contract and for the completion of the negotiations, after which time the parties will have no obligations under the letter of intent.

3. If you represent the landlord, recommend to your client that it not agree to take the space off the market.

Unfortunately, it is unlikely that the lawyer will be consulted before a letter of intent is signed. To ensure that he or she has a chance to review it, the lawyer must know that the deal is contemplated, that a broker has been hired, and that a deal is imminent. It will take a very close relationship with the client or the broker for the lawyer to have that kind of information.

4. It is my feeling that the word discretion really means discretion, and that commonly used phrases such as “sole discretion”, “absolute discretion,” and “sole, unfettered, and absolute discretion” are not necessary to get the concept across.