

**A LETTER OF INTENT IS ENFORCEABLE.
A LETTER OF INTENT IS NOT ENFORCEABLE.**

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Is a Letter of Intent enforceable? Unfortunately, there is no simple answer to whether a Letter of Intent (“LOI”) will be enforceable. It could be: (A) yes; (B) no, not at all; (C) some parts yes, and some parts no; (D) no, but it will be treated as if it were; and (E) no, but it may affect the parties’ later agreement. While most courts understand the non-binding concept of an LOI and its role in a commercial transaction, there are exceptions where a court will treat the terms of the LOI as the “real deal.”

Essentially, if the parties intended to be bound by the LOI, the LOI will be a binding agreement. If they intended to be bound to only some provisions in an LOI, they will be bound by those provisions. To the extent that all parties to an LOI intended to be bound, there only remains the question of whether a court can figure out whether the LOI contained enough crucial information such that a court can figure out what enforcement would entail. If no party disagrees that it intended to be bound and the LOI has a minimum amount of information (classically, but not necessarily in the modern contract world, it identifies the parties, the subject matter of the agreement, and the essential terms, generally price), the battle shifts from whether the LOI is enforceable as written or whether there has been a breach, and if so, what the remedies will be.

Enforceability is only an issue when one party insists it didn’t intend to be bound, because if all parties take that same position, the question of enforceability doesn’t come up in the first place. What often leads to confusion is that the test used to determine what a particular party intended is an objective one, not a subjective one. Whether a party intended to be bound by the LOI will be determined by assessing what an objective observer would reasonably believe the party intended, based upon the words (written or not) or the actions (and, in a limited number of scenarios, the inactions) of the party (who is now denying its intent). The question is: “would an objective observer reasonably believe that the party intended to be bound?” While a binding agreement (that is, an enforceable contract) requires a “meeting of the minds,” (an imperfect concept), that only means that an objective person, acting reasonably, believes there was a meeting of the minds, not that there actually was one (subjectively speaking). Accordingly, in the very limited number of cases where an LOI is treated by a court as an enforceable contract, it is because one party insisted the LOI should be enforced as an agreement and the other party gave out convincing signals, at the time of signing (or orally agreeing), that it agreed. As to signatures, don’t forget that the Statute of Frauds (where applicable, and where not subject to an exception) only can make an agreement voidable. It does not make an otherwise enforceable agreement void.

Another reason a court will treat an LOI as an enforceable agreement, even though the parties did not initially intend it to be so, is that the court looked at the subsequent course of events. Sometimes parties will sign an LOI and, while they are

negotiating the “final details,” one or both of them will start to actually perform under what they think their “final” agreement will be, and the other will accept that performance. If these acts look like the parties have objectively acted as if they had an agreement, but just haven’t worked out the final details, courts will rule that the LOI was really a finished agreement, but for the final details and the same court will be happy to fill those in using “gap fillers.”

The preceding paragraphs have addressed possibilities (A) and (B) at the very top of this article. Moving on to (C), “some parts yes, and some parts no,” is trickier because contract law has evolved over many years from being highly formulistic to trying to match the objective expectations of a commercial society. Thus, the more commercial the subject matter of an LOI, the more likely the following will be true. Classically, courts have held that “agreements to agree” were not enforceable agreements. A non-commercial example of an unenforceable agreement would be when one friend promises to take the other to the movies and to pay for the show if the “guest” would drive. When the “guest” shows up with her car and the first friend reneges, their agreement has been breached. No court would award damages to the driver because the subject matter of the agreement was purely social. That’s an actual agreement, but not one that a court will enforce.

In olden days, “agreements to agree,” though not “social” in nature, were another category of unenforceable agreements. Propelled, perhaps, by the way the Uniform Commercial Code handles such agreements when they pertain to the sale of goods, courts, for the most part, believe that when people, in a commercial setting, “agree to agree,” they have undertaken a responsibility to bargain in good faith, and many courts don’t look for “consideration.” This, of course, is jurisdiction dependent. The result is that even where a LOI doesn’t bind its parties to a set of rights and duties based on the substance of the LOI, the failure of a party to bargain in good faith may give rise to damages. That obligation to bargain in good faith is the “some parts yes” piece of (C) and the possible substantive business terms of the same LOI constitute the “some parts no” piece of (C).

In a similar way, courts may also find certain kinds of LOI provisions to be enforceable, such as those that promise: (a) access for investigation (due diligence) purposes; (b) exclusive dealing; (c) that a party won’t make material changes while negotiations are taking place; (d) non-disclosure of the negotiations; and (e) confidentiality to be enforceable. That’s true, at least until the LOI says it expires (or if there is no such date or event, for a “reasonable” time).

At the bottom of this article is text from a common style of LOI. It will show how the “unenforceable” parts of an LOI can be separated from the “enforceable” parts. Following the exemplar will probably raise the predictability of the outcome of a court challenge.

The consequence of a court finding an implicit “agreement to agree” provision in an LOI is that the parties can expect their “agreement to agree” to be enforceable.

Based on that concept, one party or the other, or both, may expend money or forgo other opportunities. Those parties are accepting the risk that no deal will ever be made, but aren't accepting the risk that the other party will just plain refuse to negotiate. So, a court is likely to award damages if Party 1, by the course of its actions, gives Party 2 reasonable grounds to believe an agreement is in place despite Party 1 having no real intention to go forward. Those damages may only be "reliance" damages because there would have been no final agreement from which to measure "compensatory" damages, or there might have been no agreement ever reached. In many cases, the court, as explained above, will treat the "agreement to agree" as an actual, enforceable contract; in others, it will engage in the fiction that there was a contract to negotiate in good faith, or will rule there was a "quasi-contract" (such as under the theory of "promissory estoppel"), but the result is the same – an award of damages.

Alternative (D) set forth above, "no, an LOI is not enforceable but it will be treated as if it were," becomes applicable when the party who denies that the LOI was intended to be an enforceable agreement induces or invites the other party to make significant changes or to take on significant commitments or to forgo significant opportunities by signaling that, despite the delays and despite some failure to settle on final contract terms, there will be a deal. A stark example is where a LOI unequivocally states that there is absolutely no possible way the LOI will be enforceable until a second document is signed in red ink by both parties, and until the company has placed a full page advertisement in the Legal News that a "deal has been signed." Then, an agreement has ostensibly been reached, but for a few truly minor details (perhaps the wording of the press release), and one side, in good faith, has made some significant expenditures based on the all-but-signed agreement. Then, the other side, with or without malice (but certainly for self-interest), pulls out. Various legal theories will apply, but the reneging party "will pay." Clearly the LOI was not an enforceable agreement, but when it comes to figuring out how much the reneging party will pay, it will be used as if it were.

Finally, to alternative (E), "no, an LOI is not enforceable but it may affect the parties' later agreement." Under this possibility, there is really no dispute as to whether the LOI is enforceable. The parties have entered into an indisputably enforceable contract. But, perhaps the contract is ambiguous, i.e., it could be interpreted in more than one way, and the parties disagree as to what one or more of the provisions mean. In such cases, courts are permitted to, and will, look outside the agreement itself, called "accepting extrinsic evidence." This is true even if the agreement specifically says that it, and it alone, constitutes the agreement of the parties and replaces all prior agreements, because there is no dispute as to whether the parties have a "different" agreement than the one in front of the court. The argument is over "what did they mean?" In such cases, a court may read the LOI that led up to the signed agreement with the objective of trying to figure out what the signed agreement really meant to say.

In a similar way, a court might look to the earlier LOI to add "obviously overlooked" provisions into a later agreement unless it is absolutely clear in the later agreement that nothing can be added from prior discussions or prior related agreements.

Certainly, particular things in the text of an LOI might tilt a court toward or away from enforcing it as an agreement. If a critical term is left out, such as a good enough description of the item to be sold, a court wouldn't know what was being sold, and it couldn't enforce the LOI as an agreement. In a lot of cases, courts think they know how to find a "reasonable" price, so just leaving out the "price" might not be a critical failure. Saying, "an amount to be agreed upon," and leaving no basis or standard for a court to imply such an amount, would be a critical failure.

Saying that a party "intends to produce" a "suitable" widget (or, one to be "agreed-upon" later) is far less likely to result in enforceability than saying the same party "shall produce a widget substantially similar to Model A, but in red." Similarly, saying that the final agreement "shall include" certain specific terms would tilt the balance in favor of enforceability, whereas saying the final agreement "would include" terms of a more general nature would tilt it the other way. Basically, if there isn't much uncertainty in the LOI's listing of the "final agreement's" terms, it starts to look a lot like the final agreement itself.

Setting an outside date or listing an event, the happening of which ends the LOI, will less likely result in the LOI being treated as the final agreement itself.

Saying over and over, perhaps, that more negotiations are needed, and not just by way of lip service, will serve to reduce the likelihood that an LOI will be treated as enforceable. This does not mean however, that if the document's title is "Letter of Intent" or if it has a simple recital that "this is not an enforceable agreement," it will be a dead end for a court. Labels and "words in the air" aren't binding on a court.

Where an LOI spells out certain conditions that need to be met, the failure of which is intended to mean "no deal," a court will pay close attention to them, especially if they are "real" conditions. For example, if there is really a "board of directors," and the deal is the kind where it would be expected that a board of directors would need to approve it, don't expect a court to make the LOI into an enforceable agreement absent such approval or absent bad faith on the part of the Board. If the LOI said that there would be no final agreement if a party couldn't get an opinion of counsel that the intellectual property rights were transferable, and that party really intended to seek that opinion, the LOI won't be enforceable if the opinion can't be obtained. One might question whether the court, in essence, is really saying that the LOI was enforceable, but was terminated because the approval or the opinion couldn't be obtained. The court doesn't even need to get there - if the approval or opinion legitimately wasn't obtained, even the duty to bargain in good faith becomes irrelevant, if not unenforceable.

Below is a common "template" for segregating "unenforceable" from "unenforceable" parts of an LOI (probably based on Steven Suleski's "Model Letter of Intent" published by the ABA in the early '90s).

PART ONE – NONBINDING PROVISIONS.

The following numbered paragraphs of this Letter (collectively, “Nonbinding Provisions”) reflect our mutual understanding of the matters described in them, but each party acknowledges that the Nonbinding Provisions are not intended to create or constitute any legally binding obligation between Prospective Buyer and Prospective Seller, and neither Prospective Buyer nor Prospective Seller shall have any liability to the other party with respect to the Nonbinding Provisions. Only when a fully integrated, purchase agreement (“Purchase Agreement”), and other related documents, are prepared, authorized, executed and delivered by and between all parties, would there be a binding agreement. If the Purchase Agreement is not prepared, authorized, executed or delivered for any reason, no party to this Letter shall have any liability to any other party to this Letter based upon, arising from, or relating to the Nonbinding Provisions.

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PART TWO – BINDING PROVISIONS.

Upon execution by Prospective Seller of this Letter or counterparts thereof, the following lettered paragraphs of this Letter (collectively, “Binding Provisions”) will constitute the legally binding and enforceable agreement of Prospective Buyer and Prospective Seller (in recognition of the significant costs to be borne by Prospective Buyer and Prospective Seller in pursuing this proposed transaction and further in consideration of their mutual undertakings as to the matters described herein).

A. Nonbinding Provisions Not Enforceable. The Nonbinding Provisions do not create or constitute any legally binding obligations between Prospective Buyer and Prospective Seller, and neither Prospective Buyer nor Prospective Seller shall have any liability to the other party with respect to the Nonbinding Provisions until the Purchase Agreement, if one is successfully negotiated, is executed and delivered by and between all parties. If the Purchase Agreement is not prepared, authorized, executed or delivered for any reason, no party to this Letter shall have any liability to any other party to this Letter based upon, arising from, or relating to the Nonbinding Provisions.

B. Purchase Agreement. Prospective Buyer and its counsel shall be responsible for preparing the initial draft of the Purchase Agreement. Subject...

C. Access.

D. Exclusive Dealing.

E. Break-up Fee.

F. Conduct of Business.

G. Disclosure.

H. Confidentiality.

I. Consents.

J. Termination; Survival.

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