

LETTERS OF INTENT: *THE GOOD, THE BAD AND THE UGLY*

By Susan Fowler McNally, Esq.

A good letter of intent is unambiguous, internally consistent and provides the prospective parties to a lease with the necessary level of safety and comfort to induce them to commit the time and money necessary to negotiate, draft and review a binding lease. A bad letter of intent may, despite disclaimers to the contrary, be construed to create a binding contract. An ugly letter of intent is one that is drafted with enough ambiguity, internal inconsistency or inconsistency with the conduct of the parties, to create an unreasonable risk of misinterpretation that could lead to costly litigation.

How do Letters of Intent Present a Risk?

The parol (word of mouth) evidence rule prohibits the introduction of evidence at a trial which contradicts the terms of a written contract; but does not prohibit the introduction of evidence of oral agreements between the parties if such evidence is not inconsistent with the contract or if the contract is either incomplete or silent on the subject of such oral agreements. Many courts have been quick to disregard the seemingly clear language contained in letters of intent in order to permit the introduction of contradictory oral evidence. An illustration of the risk posed by the parol evidence rule is vividly summarized in *Trident Center v. Connecticut General Life Insurance Company* (9th Cir. 1988) 847 F. 2d 564, in which the Ninth Circuit Court stated :

The contract documents are lengthy and detailed; they squarely address the precise issue that is a subject of this

dispute; to all who read English, they appear to resolve the issue fully and conclusively. Plaintiff nevertheless argues here ... that it is entitled to introduce extrinsic evidence that the contract means something other than what it says. This case therefore presents the question whether parties in California can ever draft a contract that is proof to parol evidence. Somewhat surprisingly, the answer is no.

Consequently, parties should be aware of the risk involved in signing even the most carefully drafted letter of intent. A commonly used method for minimizing this risk is negotiating and memorializing the deal points of a lease in a letter of intent, but refusing to sign the letter of intent and moving ahead with the drafting of the lease.

Nonbinding Letters of Intent

Most parties using letters of intent do not intend them to function as their lease (i.e., to be their binding contract). A letter of intent that is intended to be completely nonbinding should be as brief as possible to avoid the implication that it contains all of the elements of a binding lease. To avoid having a letter of intent construed to be a binding lease, it is prudent to include a disclaimer expressing the parties' intent that the letter of intent not be construed as a binding lease. A comprehensive disclaimer may include statements such as: (a) the letter of intent is intended merely as an outline to assist the negotiating parties in attempting to reach a mutually acceptable lease agreement; (b) no promises

have been made or relied upon; (c) neither party has the right to infer an agreement to negotiate the remainder of the terms of the lease in good faith or exclusively with each other; or (d) the parties do not intend to be contractually bound until their respective attorneys and/or boards of directors approve the form and content of the lease and the lease is fully executed by both parties. Bear in mind that if a letter of intent says that the lease is subject to the approval of the party's attorney and/or board of directors, then the covenant of good faith and fair dealing which is implied into all agreements will require that the party must actually submit the proposed lease to its attorney and/or board for approval. If a party does not want to execute a lease, it should be relatively simple to get its attorney or board of directors to certify to the other party that the lease has been reviewed and is not approved.

Obviously, the more carefully worded the disclaimer, the better the argument that the parties' intent not to be contractually bound is actually reflected in the terms of the letter of intent; however if the parties' conduct is inconsistent with the express

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Susan Fowler McNally is a partner at Gilchrist & Rutter in Santa Monica, Calif. Her practice focuses on commercial real estate and business transactions.

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terms of the letter of intent, there is no disclaimer strong enough to dissuade a court to exclude the parol evidence of the contrary intentions of the parties. For this reason it is important to counsel clients to be sure to act in a manner which is consistent with their objectives and intentions. A landlord that delivers possession of the premises to the tenant and makes no objection to the tenant spending a substantial sum of money on making tenant improvements will probably have a difficult time convincing a judge that the parties did not intend to be contractually bound lease merely because they never actually signed a lease.

Partially Binding Letters of Intent

If it is intended that the letter of intent be partially binding on the parties as to one or more specific obligations (e.g., binding as to the obligation to (a) negotiate in good faith, (b) negotiate with the other party exclusively for a specified period of time, (c) keep the terms of the deal being negotiated confidential, or (d) require one party to pay for the preparation of a space plan, even if a lease is not agreed to) then it is important that such provision be inserted into the letter of intent after any disclaimer provision so that it is clear that only the expressly described provisions inserted after the disclaimer are intended to be binding and none of the other provisions of the letter of intent are intended to be binding on the parties. Even when a court is willing to acknowledge that a letter of intent was not intended by the parties to function as a binding lease, the court may infer from parol evidence of the parties' conduct or oral promises that the parties had agreed to negotiate with each other in good faith and

thus would be prohibited from abandoning lease negotiations by insisting on any terms that are inconsistent with the terms set forth in the letter of intent.

Binding Letters of Intent

The party with the most leverage at the letter of intent stage of negotiations may actually want the letter of intent to be binding on the other party, or at least function to deter the other party from attempting to improve its deal over the period of time it takes to finalize a lease. Most brokers and attorneys feel that it is not honorable to ask for a concession that their client already conceded in the letter of intent (and even if they do ask, they are generally prepared to accept defeat). A party desiring a binding letter of intent (or one that at least pinches the other party) will want the letter of intent to include a recitation of all of the promises made to such party by the other, the consideration given for those promises and a statement that the party has relied upon those promises to such party's detriment. Additionally, a letter of intent that is intended to be binding should be as detailed as possible and address all potentially controversial issues in sufficient detail to preclude any further negotiation on such issues when the first lease draft is circulated for review.

Conversely, the party with the least leverage probably wants a letter of intent that is very brief, covering only the most basic deal points and leaving as much open for negotiation later as possible. Leverage is something that can change with time, so it is almost always advantageous to the party with the least leverage to leave the

door open to a possible improvement in its leverage by agreeing to as few deal points up-front as possible. The downside of this strategy is that some points (e.g., obtaining a non-disturbance agreement or free rent) are generally deemed to have been conceded if they are not addressed in the letter of intent.

Drafting Tips

Letters of intent should be carefully reviewed to eliminate internal inconsistencies and ambiguities, to include any necessary missing information (e.g., the names of the parties, the address of the property to be leased, the term of the lease, the rent rate and other economic terms of the lease) and to ensure that the terms included in the letter of intent are consistent with the parties' objectives and actions.

If a letter of intent is intended to be binding, or partially binding, it should address what remedies will be available to the non-defaulting party in the event of a breach of the letter of intent. Examples of remedies to consider include liquidated damages, recovery of actual out-of-pocket costs, recovery of lost profits (if the premises are taken off the market for a period of time while the parties were obligated to negotiate with each other exclusively), specific performance or other injunctive relief.

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