Letters Of Intent (With Sample Clauses)

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Letters of intent can be troublesome, but if a client insists on one, the guiding principle of drafting it should be “less is better.”

HOW OFTEN when you are asked to prepare a letter of intent do you ask yourself or your client, “Do you really want to do this?” Or, “Why don’t we draft the operative agreements and negotiate those rather than a letter of intent?” We all know the answer—the client wants to see if a deal can be made without spending too much time and money on negotiations that may lead nowhere. I doubt that answer alone justifies preparing the letter of intent or the risks involved, particularly to a seller, lender, or landlord, should the “preliminary agreement” become an enforceable obligation. All too often, lawyers and their clients fail to appreciate the dangers inherent in a letter of intent until it is too late. See Texaco, Inc. v. Pennzoil Co., 729 S.W.2d 768 (Tex. App. 1987).

WHAT IS IT? • A letter of intent is generally understood to be a preliminary statement of the more important business terms of a transaction and there is an expectation of the need for further and final documentation of that transaction. For our purposes, the terms “letter of intent,” “memorandum of understanding,” “gentleman’s agreement,” “agreement in principle,” “term sheet,” and “heads of agreement” are synonymous. However, I prefer “letter of intent” because the title does
not contain a word that is or implies agreement. Stephen Volk (see Bibliography) has described the letter of intent as “an invention of the devil and should be avoided at all costs.” An English jurist had the following comment: “A gentleman’s agreement is an agreement which is not an agreement, made between two persons neither of whom is a gentleman, whereby each expects the other to be strictly bound without himself being bound at all.” Another author has said that it is the client’s goal in entering into a letter of intent to bind the opposite party, but not himself. Likely, the other party to the letter has the same goal, but the name of the bound party is reversed.

Letters of intent are said to be useful in confirming to third parties (lenders, investors, partners, landlords) that a deal in principle has been reached. They also allow negotiators to identify and concentrate on resolving the open issues of a deal. In some instances the letter of intent provides for the property to be taken off the market for a period of time or bars one side from shopping the deal to third parties during an agreed period of negotiations.

Should the letter of intent be long or short, specific or general? My view is that less is best if you want to avoid being bound by the letter. I have seen lease letters of intent that are almost as long as the lease. The longer the letter of intent, the longer it takes to negotiate. An exception to this rule may be the loan commitment which is frequently considered to be a binding agreement, enforceable against the lender (but not usually enforceable against the borrower), subject only to memorializing the agreement in the loan documents. Seldom are there significant business terms left to be negotiated after a loan commitment is entered into.

TYPES OF LETTERS • Professor Farnsworth’s article in the Columbia Law Review (see Bibliography) describes the typical letter of intent as falling into one of two categories. The first is an agreement with open terms. This type of letter sets out some terms by which the parties agree (explicitly or implicitly) to be bound. The parties also agree to negotiate on open terms to be included in an ultimate agreement for the transaction. The open terms to be negotiated can be specifically identified, or the parties may acknowledge only that there are some unspecified terms to be negotiated. Specificity is better if one party hopes a court will fill in the open terms should negotiations fail. If the letter of intent is enforceable (and we will get to this later), liability under it may arise if the parties fail to negotiate. If they do negotiate, but cannot agree, the parties are bound by what they agreed to and the open matters are subject to court determination, where possible. The problems inherent in such an agreement include whether or not the parties intended to be bound and the likelihood of a court being able to adequately determine the parties’ intent on the open matters. The mere
reference in this type of letter to the need for and expectation of a mutually acceptable ultimate agreement for the transaction may or may not resolve the question of the parties’ intent.

The other type of preliminary agreement discussed by Professor Farnsworth is one that contains the substantive terms of the transaction, but the parties have not agreed to be bound by those terms. This is basically an agreement to conduct negotiations and it is likely that no one is bound to any point. An interesting issue is the obligation of the parties to conduct negotiations with each other. What happens if one party fails to negotiate or chooses to negotiate with a third party? It seems unrealistic to believe that parties to a letter of intent would not want to be bound by some of its terms since a totally non-binding letter of intent is of no apparent value, but it may have some persuasive effect for some period of time.

**Binding Or Non-Binding?**

For a letter of intent to be a binding contract, it must contain the essential terms of the contract and the parties must intend to be bound by them. Certainly, if the letter of intent involves real estate, the letter must fulfill the requirements of the Statute of Frauds. Therefore, one way to ensure that a letter of intent is not enforceable as a contract is to omit an essential term or to fail to satisfy the Statute of Frauds. Essential terms will vary from deal to deal and I doubt that there is an absolutely complete list of essential terms for any transaction. With respect to real estate, it is probably desirable to have an inadequate legal description if the parties want to avoid enforcement of the letter based on a violation of the Statute of Frauds. The question of what the parties intended by entering into the letter is not easily answered where the letter of intent does not specify if the parties are to be bound in whole or in part. Much of the case law on letters of intent has been developed as a result of the courts attempting to discern the parties’ intent. *Scott v. Ingle Bros.*, 489 S.W.2d 554 (Tex. 1972) is the leading Texas case on determining the intent of the parties in a transaction in which some terms were specifically agreed upon, but other aspects of the transaction were not documented. The Court held that the intent of the parties was a question of fact, not law. Therefore, a jury will usually decide intent and their decisions defy categorization or simple analysis. Stephen Volk has observed that the cases dealing with the intent of the parties who have entered into a letter of intent is “all over the place.”

Language that has been held to indicate an intent to create a binding obligation includes:

- “Please indicate your acceptance on the enclosed copy of this letter and return to us”;
- “The parties will execute a definitive lease in the usual standard form of business lease in this community”;