

LETTERS OF INTENT – ARE THEY ENFORCEABLE?

By Dale Alberstone

When negotiating purchase agreements of real property, buyers and sellers often exchange letters proposing and counter-proposing terms and conditions of the sale. Those communications typically form the basis for entering into a lengthy formal contract which documents all of the major and minor terms of the deal. The mutually acceptable provisions in the many letters are then frequently consolidated into single letter or document which summarizes the points upon which the parties agree. Typically, that summary includes only the terms that the buyer and seller feel are particularly important to the transaction, such as price, financing, entitlement periods, inspections and applicable contingencies. Provisions which the bargaining parties believe are less significant, or at least will be relegated to custom (such as the appropriate division for payment of the escrow company's fees and the payment of the documentary transfer tax), may be left for documentation in the finalized purchase agreement.

While the various exchanges of correspondence could, under certain circumstances, be collectively construed a "letter of intent" between the parties, typically, a single, consolidated short form document signed by the buyer and seller will be denominated as the letter of intent.

My column this month discusses the nature and legal effect of an LOI. In that regard, I have in mind that the parties have verbally, or by an exchange of correspondence, tentatively agreed upon the significant terms of the transaction and thereafter consolidated them in a single document.

Parties typically believe that their letter of intent is not a legally enforceable contract. Instead, they consider the letter to be merely a summary of the major terms of the transaction which are then to be included and augmented in a full, generally multi-page, contract which is signed by both parties.

The reasons parties use a letter of intent is because it is less expensive and easier to draft an LOI than the complete contract. If the parties are not able to agree on the material terms of the deal, they may save thousands of dollars in legal fees which might be incurred in connection with the drafting of a full contract.

Problems arise with letters of intent where the LOI itself contains provisions stating that the parties agree to one thing or another. For example, an LOI may state that the parties agree to negotiate with each other to work toward a fully documented contract. Or it might say that the LOI contains all of the material terms of their "agreement" with the remaining terms to be supplied in the finalized document. Significantly, when a letter of intent acknowledges that an agreement has been reached on the material terms, a court may enforce the LOI as a contract, even though the less important terms were to be supplied at a later time.

The California Court of Appeal explained in Harris v. Rudin 74 Cal.App. 4th 299: "Whether a

writing constitutes a final agreement or merely an agreement to make an agreement depends primarily on the intention of the parties. In the absence of ambiguity this must be determined by a construction of the instrument as a whole. The objective intent as evidenced by the words of the agreement, not the subjective intent, governs our interpretation.” (Pg. 307)

In Harris, the court determined that the use of the words “initial draft” in the letter alone was not conclusive as to the intent of the parties. The court concluded that because the letter of intent purported to set forth the essential terms of the agreement and contained a signature block for acceptance, the document might be construed to be a contract rather than simply an agreement to agree in the future.

On the other hand, letters of intent which demonstrate that they are nothing more than an “agreement to agree” in the future are unenforceable. However, one needs to be careful about that concept because if the LOI provides that the parties agree to continue to negotiate the terms of a transaction, but one of the parties thereafter fails to do so, the other party may sue for damages for that breach. In the recent case of Copeland v. Baskin Robins 96 Cal.App. 4th 1251, the Court of Appeal held that a party to a commercial transaction can sue for breach of an agreement to negotiate even if the parties never reach a final agreement. In other words, if the LOI sets forth some of the terms of the transaction and also provides that the parties agree to negotiate the remaining terms, each party must thereafter do so in good faith, lest he be exposed to damages for that breach. (As an aside, proving those damages by a preponderance of the evidence before a jury may be an impossible task. Further discussion of proof of such damages is beyond the scope of this article.)

The essential material terms and conditions for a valid contract of sale and purchase of real property include the following:

- (1) The identification of the property, generally by street address or legal description;
- (2) The names of the buyer and seller;
- (3) The price for the purchase;
- (4) The terms of payment of the price, including any contemplated financing;
- (5) The time period for the performance of the transaction, or the date for the close of escrow.
- (6) A recital that the document is agreed to by both parties; and
- (7) The signature of the parties on the document.

Where each of those seven elements is contained in the LOI, the LOI itself might then become itself a binding contract. That is perhaps best illustrated by a Superior Court action which I settled in favor of my “buyer” clients on March 23, 2007. The basic facts were as follows: On December 16, 2006, my clients and the owners of a single family residence in Irvine, California, jointly executed a single page document which summarized the terms and conditions for my clients’ purchase of the \$1.4 million home. In the document, the property was described by street address, the names of the parties were set forth, the purchase price and \$25,000 down payment were recited, escrow was to close on April 26, 2007 and the seller was responsible for preparation of the “Buy/Sell Agreement.” The document was then signed as “agreed to this date” between the parties. Also, the document was entitled “Home Sale Agreement.”

After the sellers obtained an attorney to counsel them in connection with the transaction, they unilaterally cancelled the sale contending that the signed “agreement” was nothing more than a non-binding letter of intent.

My clients, who desperately wanted the house, engaged my firm to compel the sale by filing a lawsuit for Specific Performance, coupled with the recordation of a Notice of Pendency of Action (“Lis Pendens”).

The recordation of the Lis Pendens prevented the property owners from reselling their residence to another buyer during the pendency of the litigation. Also significant was the fact that because the single page signed “agreement” did not contain an attorney’s fees clause, the sellers recognized that they would spend tens of thousands of dollars in defending the case without any chance of reimbursement from my clients even if the sellers prevailed at trial.

Confident that they, rather than the sellers, would prevail at trial, my clients refused to dismiss the case notwithstanding the persistent demands of the sellers’ counsel.

Faced with expensive attorney’s fees and questionable chances of prevailing, the sellers settled the case with my clients less than 30 days after we filed the February 26, 2007 Complaint. In connection with that settlement, my clients and the sellers executed a detailed eight page contract on a C.A.R. form for the same purchase price and substantially the same terms as that set forth in the original one-page “agreement.”

RECOMMENDATIONS

To avoid problems with whether or not a letter of intent is enforceable, or even constitutes a binding contract, the parties should implement one of two approaches:

(1) Include language similar to the following at the end of the LOI:

“The parties acknowledge that this non-binding letter of intent (“LOI”) does not address all the essential and material terms of the transaction contemplated by the parties. Neither party may

claim any legal rights against the other by reason of the existence of this LOI or by reason of actions taken in reliance upon this non-binding LOI. This LOI shall not be binding upon the parties and the parties understand that no binding agreement shall exist between the parties unless and until a fully executed contract is hereafter executed by the parties.”

(2) Better still, do not sign the letter of intent. Instead, agree verbally to the terms contained therein and then draft the complete contract for execution.

CONCLUSION

In general, a letter of intent can constitute a binding contract, depending on the intentions and expectations of the parties. What the courts will consider is whether the parties agreed to the material terms of the transaction in the letter of intent or whether they left some material terms for future agreement, thereby making it merely an “agreement to agree.” While “agreements to agree” are unenforceable, if the only remaining terms to be agreed upon are immaterial in nature, or can be supplied by custom, a court may issue a judgment enforcing the so-called letter of intent as a binding contract.

In conclusion, letters of intent are wonderful vehicles for purposes of negotiating the terms of a contract. However, if the parties elect to sign an LOI, be certain that it contains the appropriate language disavowing the fact that it constitutes an existing agreement.

BIOGRAPHY

Dale Alberstone is a prominent real estate attorney who has practiced real property and business law in Century City for the past 31 years. He has been appointed to periodically serve as a judge pro tem of the Los Angeles Superior Court and is a former arbitrator for the American Arbitration Association. He also testifies as an expert witness for and against other attorneys who have been accused of legal malpractice.

Mr. Alberstone has been awarded an AV rating from Martindale-Hubbell. An AV rating, registered through Reed Elsevier, reflects an attorney who has reached the heights of professional excellence and is recognized for the highest levels of skill and integrity.

The foregoing discussion is intended as a general overview of the law and may not apply to the reader’s particular case. Readers are cautioned to consult an advisor of their own selection with respect to any particular situation.

Address correspondence to Dale S. Alberstone, Esq., ALBERSTONE & ALBERSTONE, 1801 Avenue of the Stars, Suite 600, Los Angeles, California 90067. Phone: (310) 277-7300.