

The Ties That Bind: When Using a Letters of Intent, Be Careful You Don't Get More Than You Bargained For

**By
Greg K. Erwin
Winstead Sechrest & Minick**

Real estate continues to be a highly sought after vehicle for both value-oriented and return-driven investors. Pension funds are increasing allocations for real estate holdings at the same time individuals are pumping money into real estate investment trusts and other publicly traded real estate companies. Getting a real estate deal off of the ground requires a lot of tire-kicking and due diligence. How best to get started? One of the most common methods is the so-called "letter of intent." But – like all documents in a deal – you need to know a few things about letters of intent before jumping in and signing on.

What is a Letter of Intent?

A letter of intent ("LOI") is a written document signed by the parties to a proposed transaction wherein they express their basic intent on the important terms of the proposed transaction and how they plan to proceed with respect to the proposed transaction, without generally intending for the proposed transaction to be binding or enforceable against them or for the document to expose them to any potential liability. An LOI can be referred to by any number of other names such as Memorandum of Understanding, Letter of Understanding, Term Sheet, Transaction Outline, Agreement in Principle, etc. However, since an LOI is normally not intended to establish a binding agreement among the parties to consummate any transaction it is preferable not to title this document with the term "agreement".

Why Use an LOI?

An LOI serves to focus discussion on the material terms of the proposed transaction. It provides a comfort level for the parties in going forward with additional time, effort and expense knowing that they have initially established a basis upon which the proposed transaction could be consummated. An LOI also provides some measure of "ethical glue" – issues traded for should not be re-traded.

When Not to Use a Letter of Intent? An LOI may become so detailed and overly negotiated that it is as expensive and time consuming as the definitive agreement, but lacks enforceability. You may get bogged down in negotiating the LOI and lose the window of opportunity for the deal. Simple transactions do not need an LOI – it's easier to go straight into definitive agreement.

Some other downsides to using an LOI:

- If negotiated only by businesspeople prior to involvement of lawyers, the legal significance of points traded may not be fully realized.
- LOIs generally favor the tenant/buyer. Questions as to the binding nature of the LOI are decided by a judge or jury. Just the threat of litigation as to whether or not the deal is "binding", may adversely influence the landlord's/seller's bargaining position.

Non-Binding Provisions

The LOI should not establish any agreement (i) as to the terms of the proposed transaction, (ii) to consummate any transaction or (iii) to enter into any definitive agreement. The terms of the proposed transaction as expressed in the LOI should be expressly stated to be non-binding. Moreover, the LOI should expressly state that the parties do not intend to be legally bound to consummate any transaction unless and until they execute and deliver a "definitive written agreement" in which they agree to be bound. Be especially careful not to use any words ("agree", "offer", "accept" etc.) in the non-binding provisions of an LOI that state or imply that an offer has been extended or that an acceptance has been solicited or otherwise that an agreement has been (or may be) formed. The LOI should set forth the material proposed business terms of the deal, *e.g.*, as to a sale:

- Name of buyer and seller
- Property to be purchased
- Price and terms
- Duration of inspection period
- Closing date
- Who pays for title policy, survey, commissions, etc.
- Special "deal" points, such as restrictive covenants, reserved easements and the like

Binding Provisions

Although generally thought to be non-binding, the LOI may contain binding agreements as to certain matters on which the parties need agreement before they proceed. Any of these matters could be (and sometimes are) addressed in a separate written agreement apart from the LOI. Normally these agreed matters will not directly pertain to the terms of the proposed transaction, but to ancillary matters, such as:

- Access for due diligence purposes, inspections and any related indemnity
- Exclusive dealing, no-shop, and stand still agreements

Practice Pointers

To achieve the desired results (no binding agreement as to the terms of the deal), consider the following:

- Name the document and let it refer to itself internally as a "letter of intent".
- Provide a clearly marked "EXIT" to be able to cleanly move to the next deal.
- Follow good rules of draftsmanship just like you would in any other legal document.
- Try to anticipate all "deal points" and include these in the LOI. A deal point is any point which if not resolved will keep the deal from closing.
- Clearly set out and separate in the body of the LOI the binding provisions from the non-binding provisions. Alternatively, put the binding provisions in a separate document.
- Clearly state that the non-binding provisions are not legally binding on the parties and that the parties do not intend to be bound to the proposed transaction unless and until they enter into a definitive agreement wherein they agree to be bound.
- To avoid the other party from asserting reliance, estoppel and course of dealing to try to enforce an otherwise unenforceable LOI, advise the client that until the definitive agreement is signed, it must not take any actions or make any statements that are inconsistent with the non-binding nature of the LOI.
- Try to keep it reasonably brief and don't get bogged down trying to resolve the specific details of all the foreseeable issues that will have to be eventually resolved. You need to strike a balance. If the parties want to resolve all of the issues necessary for a definitive agreement, you might just as well skip the LOI and go directly to the definitive agreement.
- In some states (Texas, for instance), there is no implied obligation to negotiate in good faith to reach a legally binding agreement – so if the parties want such an obligation, it needs to be expressly stated.

LOIs are useful tools for the conclusion of real estate deals. Careful consideration must be given as to clearly enunciating the parties' intentions – to be bound or not – in an unambiguous manner. In all events, don't let your clients behave under the LOI like they have a final deal, or they may find out that they do!

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Greg K. Erwin is a real estate attorney for Winstead Sechrest & Minick P.C. and is based in the firm's Houston, Texas office. For more information concerning this topic contact Greg at 713/650-2781, or by email at gerwin@winstead.com.