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Articles

DRAFTING A MORE PREDICTABLE LETTER OF INTENT--REDUCING RISK AND UNCERTAINTY IN A  
RISKY AND UNCERTAIN TRANSACTION

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\*186 [I]n most cases, a letter of intent is an invention of the devil and should be avoided at all cost.<sup>1</sup>

## I. Introduction

In the past, letters of intent (LOIs), memorandums of understanding (MOUs), agreements to agree, memorandums of agreement, and similar documents<sup>2</sup> were used rather sparingly and in very narrow transactional circumstances. Traditionally, an LOI was used only in conjunction with very high dollar \*187 transactions and/or complex arrangements. Such transactions typically included asset divestitures, mergers, large joint venture formation and operation, acquisitions involving large corporations or a combination thereof. Today, however, an LOI seems to be a common precursor even to routine transactions such as software licenses, joint development agreements, buy-sell arrangements, co-marketing arrangements, Internet deals, manufacturing services agreements, intellectual property licenses, and other similar transactions. In addition, these LOIs are

being used in a business climate that is more fast-paced than ever before, where multi-million and multi-billion dollar transactions begin, and sometimes catastrophically fail, on a daily basis. Further, large high-tech corporations engaged in the global marketplace participate in more inter-company transactions now than ever before.<sup>3</sup> The fast-paced and rapidly-changing transaction-generating machine that characterizes modern business, coupled with common and almost careless execution of LOIs, creates a situation in which the form and content of the LOI may mean the difference between litigation and an amicable termination to the negotiations.

Section II of this paper explains what an LOI document is and its possible legal effects. Section III then identifies common situations in today's business environment that are likely to give rise to the use of an LOI and whether or not an LOI is advisable in those contexts. Section IV discusses the numerous factors that U.S. courts generally consider when making a determination as to whether an LOI is contractually binding, partially binding, or non-binding upon the signatory parties. Building on this information, Section V introduces a proposed model instrument that is referred to as a semi-binding LOI, or semi-binding memorandums of understanding. This semi-binding LOI contains both binding and non-binding sections that are clearly delineated and identified. The non-binding section performs the function of the traditional LOI, narrowing the issues for subsequent negotiation by setting forth the intent of the parties with all the characteristics of a non-binding LOI. The binding section of the semi-binding LOI contains content similar to boilerplate language in a basic commercial or technology contract. More specifically, the binding section of the LOI (1) ensures that the non-binding sections remain non-binding; (2) sets levels of transactional risks in both the LOI, the subsequent negotiation, and the ultimate contractual agreement; and (3) sets forth common binding terms and conditions intended to reduce uncertainty, such as stating a binding choice of law and a short termination date for the LOI. Section V also generally discusses the recommended terms that likely would be present in both the binding and non-binding sections of this semi-binding instrument.

## **\*188 II. What Is an LOI and Its Possible Legal Effect?**

An LOI usually takes the form of a brief written document of roughly one to five pages and sets forth the skeletal structure of a transaction in a somewhat informal format. A typical LOI usually resembles a mini-contract. However, an LOI may also be created through an informal letter, an attorney's contract term sheet, an e-mail exchanged between parties as a statement of work, oral conversations,<sup>4</sup> or a set of foils presented at a meeting. In the most common mini-contract form, the LOI is a written document that is signed by two or more parties of interest.<sup>5</sup> The body of this document usually outlines the party's intent to engage in some form of business and anticipates, either explicitly or implicitly, continued negotiations to reach a final agreement on the desired relationship. When properly used, the LOI generally is intended to be the first step in a two-part transaction where execution of the LOI is intended to be a precursor to a more detailed and definitive agreement executed at a later date.

The question of "what is an LOI?" is much easier to answer than "what is the legal effect of an LOI on the involved parties?"<sup>6</sup> Some courts construe an LOI as a wholly worthless exercise between the parties whereby the LOI has no legally binding effect whatsoever.<sup>7</sup> In this case, the court will not hold either party's feet to the fire over any terms and conditions of the LOI in any situation. If one or both parties are expecting the other to be bound to some of the terms in the LOI, the court's holding may be extremely unpleasant, not to mention costly.

In other situations, some courts will interpret the content of the LOI as a non-binding instrument but will construe the presence of the LOI as indicating some relationship or duty between the parties. As a result of this implied relationship or duty, the court can require that the parties deal with each other in good faith and/or mutual cooperation, even absent an express statement in the LOI of such an \*189 understanding.<sup>8</sup> Therefore, even though the specific content of the LOI is not binding, the existence of the LOI may create a duty or relationship between the parties whereby some freedom of action is compromised and/or some forms of conduct by a party will be viewed as unacceptable by the court.<sup>9</sup>

Yet other courts will scrutinize the underlying facts, the conduct of the parties, and the form and content of the LOI and find that some of the terms of the LOI are binding upon one or more parties while other terms in the LOI are wholly unenforceable.<sup>10</sup> This outcome is particularly worrisome, as the resulting contractual arrangement may be wholly outside of the party's original expectations. If a contract or LOI is a "middle-of-the-road" agreement when enforced as a whole, it may be quickly biased against one party if some portions are found binding while other portions are not. As an example, imagine Company A being forced to pay object code software royalties to Company B under a binding term in an LOI while Company B's obligation of object code support and upgrades is declared non-binding by the court. This holding could render the object code wholly worthless in the hands of Company A and change the balance of power in subsequent negotiations and

dealings.

In a final possible outcome, a court may construe the entire LOI as a complete and binding agreement between two parties.<sup>11</sup> In these cases, the court may use common law or statutory provisions (e.g., the U.C.C.) to fill in crucial open or indefinite terms and conditions not expressly set forth within the LOI.<sup>12</sup>

In any event, in order to obtain a definitive conclusion as to the actual effect of most forms of LOIs, expensive litigation and a significant amount of lapsed time during trial is usually an unfortunate necessity.<sup>13</sup> The wide and unpredictable range of LOI outcomes possible in state, federal, and foreign sovereign courts is largely \*190 what renders the LOI a such dangerous instrument. An experienced businessperson can usually feel comfortable taking risk, performing risk-reward assessments, and deftly steering clear of undesired risk if they definitively know the dangers and outcomes of their action or lack thereof. Many LOIs, coupled with facts and circumstances surrounding them, generally do not allow an attorney to provide definitive legal counsel to clients through which prudent business decisions can be fully weighed. It may not be clear which sovereign's law applies or what terms (if any) are binding, and the language of the LOI may be so tenuous that specifics are impossible to ascertain. Compounded with the uncertainty of its resulting legal effect, the LOI is sometimes looked upon by some businesspeople and attorneys as a relatively unimportant document that should be quickly completed in order to move on to the more "important" matters. Therefore, these tenuous documents often are signed without serious considerations of the consequences, without serious formulation of the contents, and without a comprehensive review of counsel.<sup>14</sup>

In summary, the LOI is a document that may have a wide range of uncertain legal effects resulting in a wide range of financial risks and rewards.<sup>15</sup> Often, litigation between disagreeing parties based on lost business opportunity is usually the only road toward obtaining a definitive resolution, especially when emotions run high and expectations are not met.

### **III. In What Situations Are LOIs Generally Used?**

LOIs are being used in an increasing number and type of business transactions in many different industries. In many circumstances, the LOI is used in an improper, wasteful, and/or unnecessary manner. In these cases, it would have been much better to wholly avoid the use of the LOI and focus strongly either on further oral negotiation or on the effort required to move directly to the execution of a formal contract. However, in spite of the many improper uses of the LOI, there are a few circumstances in which the use of an LOI is supported by some convincing legal or business rationale. Both proper and improper uses of the LOI are set forth below. A poor decision to use an LOI in the wrong circumstance should not be made worse by executing poorly-chosen LOI content.

#### **A. The Frustration LOI**

In some cases, two parties who desperately want a transaction to occur cannot even come to agreement on the basic framework of the arrangement. One party \*191 may want to jointly develop the product and intellectual property (IP) while the other party wants to develop the product and intellectual property individually. One party may want expansive indemnity, while the other party desires to substantially reduce its indemnity and warranty risk in order to reduce its average sales price. After these parties negotiate in vain for many weeks or months, one or more executive(s) inevitably come(s) up against a deadline. Nothing has been even remotely agreed upon, but something must be placed in a quarterly report, tax events loom on the horizon,<sup>16</sup> employees or the press must be informed, or the board of directors needs concrete information to go forward with other business. In other cases, the parties may suffer from the wholly understandable human trait of simply desiring to see something "positive" accomplished as a result of their months of effort. In a panic, with good intentions, or out of sheer frustration, the parties reduce their total lack of understanding and lack of a workable transactional framework to an LOI and sign it. As strange as it sounds, the "frustration LOI" happens more than one would like to admit.

Nothing could be worse than this particular use of an LOI. Seen in the best possible light, the results of this type of use of an LOI are that: (1) both parties simply waste their time on an LOI rather than focusing on the real task at hand, which is to continue discussions in order to agree on at least a basic working framework for the transaction; and (2) the parties waste several hundred dollars an hour in attorney fees to generate a meaningless scrap of paper. In a worse case scenario, the deal, which by its very nature is very likely to fail, falls apart and the parties wind up in expensive litigation over the meaning and effect, if any, of the LOI. Even if the court decides that the LOI is not binding, the attorney's fees are gone, opportunity has been lost (attorneys, businessmen, and employees can do more useful things than litigate frustration LOIs), and a potentially

beneficial relationship between two parties has been damaged, maybe permanently. In the worst case scenario, in addition to the above unpleasant possibilities, a court may rule that the LOI was a contract, in whole or in part, and that a party has breached binding portions of the LOI. In this case, that party may be forced to pay damages or engage in a transaction that it never really determined was good business to conduct in the first place. For obvious reasons, frustration LOIs should be avoided if at all possible.

## **B. The Poor Man's Contract**

Attorneys are expensive, and negotiating a contract is sometimes viewed by management as nothing more than an annoying time delay in the sequential process of doing profitable business. Wasting time by bickering over detailed language in a forty-page agreement that primarily addresses scenarios that may never occur (e.g., bankruptcy, failure to develop the product, mediation, press releases, record audits, indemnity, termination, personal injury, or IP infringement) is especially annoying to an action-oriented businessman. A six-month delay to market may mean a \*192 company is out of business or at least is not keeping pace with the competition, leading some to feel the understandable, yet dangerous, need to race through the paperwork process and get on to the profit.

In these cases, the parties may write an LOI that is intended as the final contract or agreement between the parties.<sup>17</sup> The businessperson may feel good about this type of use of the LOI because less time is “wasted” and he did not have to pay the large attorney fee bill at the end of the quarter. In many cases the LOI references or anticipates the negotiation or execution of a final contract. However, the parties both understand and generally agree that such a negotiation will never even be attempted. The LOI will be the deal. Unfortunately, the LOI usually leaves many terms and conditions to chance.

Regardless, if this LOI is litigated, whether it is found to be non-binding, partially non-binding, or binding, at least one party, probably more, in that transaction will be extremely irritated with its future attorney's bills. These LOIs, by their very nature, generally do not anticipate any change in the market, the party's strategy or organization, long term allocation of risk, or other contingencies and conditions. To accommodate such changes, additional negotiations (where one party is usually at an extreme disadvantage) or a lawsuit is needed to “fill in the terms” that the parties cost-cut in the first place. In addition, if the LOI is found to be binding or semi-binding on both the parties, too many details and intricacies usually are missing from the LOI, forcing the court to perform guess work, resort to extrinsic evidence, rely on default statutory provisions, or liberally interpret the LOI language to determine the full and definitive extent of obligations placed on the parties. Such parties may suddenly find that they are bound to costly IP indemnities,<sup>18</sup> broad warranties,<sup>19</sup> or other terms and conditions that they did not consider, did not factor into price or risk assumption, and did not want to honor in the first place. Simple, yet largely legal, issues, such as choice of law, integration clauses, force majeure, license grants, termination, confidentiality, and other standard content found in attorney-drafted documents are likely to be wholly left out of a “poor man's contract”, thereby creating further problems for one or more of the parties. Simple matters, such as how to ensure that one has a requisite license grant, become painful exercises of wading through issues such as doctrines of implied licenses, estoppel, oral agreements between executives, and extrinsic evidence. An LOI should be of very short duration, executed in express anticipation of a final agreement through more negotiation, and never used as a contract substitute through which substantial financial and/or resource investment is made.

## **\*193 C. The Deception Contract**

Occasionally, a party will lure another party into signing a seemingly innocent and non-binding LOI in the hopes of eventually creating a binding contract from the LOI. An LOI that strategically does not follow the non-binding guidelines of this paper may be interpreted by a court of competent jurisdiction, in whole or in part, as a contractual document. In other cases, the LOI may be tailored to result in a contract on its face or may be written with the knowledge that an investigation into extrinsic evidence of intent to contract will be necessary to make the LOI binding (e.g., e-mails, letters, meeting notes, foils, voice mails, or oral conversations). This type of LOI may bolster arguments of an oral contract or a contract by oral modification of the LOI and may even result in a contract under generally accepted contract principles such as detrimental reliance, promissory estoppel, and performance by the parties. In addition, a party may execute a seemingly innocent purchase order; order acknowledgement referencing the LOI or superceding the LOI; or pay for services under the LOI with a check and argue that this second transaction created a new contract regarding the parties anticipated arrangement.

Usually, when this type of tactic is used, it is used by an individual or a small legal entity dealing with a larger corporation.

The smaller entity often does not have the legal power or the internal legal infrastructure that the larger corporation can bring to bear in a negotiation, and the smaller entity may not have the strongest bargaining position. A vague LOI that opens up a lot of ground, coupled with favorable statutory default provisions or a sympathetic jury, can go a long way to “leveling the playing field” for the smaller entity. In addition, the larger party typically assumes more risk. Usually, the smaller entity is more thinly capitalized than the larger party, and in many cases may be largely judgment-proof. Therefore, if the LOI falls apart due to failure on the part of the smaller entity, it is unlikely that a large corporation will sue on a shaky LOI in an attempt to obtain a remedy that cannot be fully collected in the end. However, it is much more likely that the smaller entity will attempt to enforce the LOI against the larger corporation should the larger corporation falter in its adherence to the LOI. The smaller entity has much more to gain and many diverse avenues to pursue recovery, thanks to the vague and indefinite LOI documentation. Furthermore, courts generally look to the larger corporation as “knowing better.” The larger corporation probably has many attorneys, is familiar with methods of doing business by contract, and could have protected its interest and reduced its risk more effectively than by using an unpredictable LOI subject to many different interpretations. In many cases, the larger corporation is the entity that initially drafted the LOI.<sup>20</sup> In these cases, the court is likely to be less forgiving to the larger corporation and may even construe \*194 the contract against the larger LOI-drafting corporation to its detriment.<sup>21</sup> Generally, this method of LOI use is unadvisable, especially for the larger legal entity that is shouldering the majority of the risk, exposure, and obligations in the transaction.

#### **D. The Deception Non-Binding LOI**

The “deception non-binding” LOI is the tactical inverse of the deception contract discussed above. Generally, this LOI is used by the larger corporation in an attempt to “come in under the radar” of a smaller company. The larger company may attempt to deceive a smaller entity into believing that it is subject to a binding or semi-binding LOI, when the LOI is really non-binding or tilted in the larger corporation’s favor. The LOI may be intended to induce reliance or performance on the part of the smaller entity to the potential future benefit of the larger company, while leaving an escape hatch for the larger entity to exit the transaction with no obligation or liability to the other party. The LOI is viewed by the corporation as an option (i.e., “if things go well I’ll do the deal, if they don’t I can walk with little risk of liability”). In other formulations, the larger entity may selectively ensure that certain portions of a contract are binding to its benefit, while terms and conditions that are not so generous or advantageous to it are likely to be non-binding or at least reduced in their overall impact.<sup>22</sup> These tactics may be very subtle, such as an innocent-looking, yet strategic, choice of law.<sup>23</sup> Other tactics are more one-sided and obvious.<sup>24</sup>

This type of transaction may lead to “good” returns the first few times it is used in the market. However, too much of this bait-and-switch LOI tactic catches up with corporations and eventually results in reputation erosion that begins to affect the corporation’s ability to negotiate new arrangements with repeat parties in a timely and effective manner. This type of LOI use is ill-advised.

#### **E. The Press Release LOI**

Frequently, stock prices, a favorable analyst rating, a good quarter’s return, market share improvement, etc., are a function of the timeliness of one or more press releases and the hype that it generates. For this reason, executives are more \*195 eager than ever to release a favorable announcement over a signed LOI rather than wait a few weeks or months for the formal contract to churn itself out.<sup>25</sup> This is especially true if the good press announcement is needed in order to offset some other bad corporate news or to counter a favorable press release from a competitor. This methodology usually seems careless from a purely contract law perspective. The transactional attorney may privately ask, “Why would any entity announce an agreement over an LOI that is truly no agreement at all and may never result in a final agreement?” The businessperson, on the other hand, is probably thinking that the adverse consequences of being unable to close the deal favorably are worth the benefit of instantaneously increased shareholder satisfaction or the preemptive strike that will immediately be made against a competitor. Many LOIs are executed primarily for public-relations reasons, market reasons, tax reasons, or budgetary reasons, whether or not transactional attorneys think it is a bad idea from a commercial law perspective. Accordingly, counsel should be willing to accept this tactic and mitigate risk for clients when they use these types of “press release LOIs” against the advice of counsel.

#### **F. The LOI Intended to Reduce Risk and Narrow Negotiation Issues**

Many modern deals today are very complicated and are usually approached in a hierarchical manner. The major items and

skeletal structure of the deal are hammered out first. These skeletal business model discussions generally include cost, resources, time, and the general assumption of risk by the parties. For example, the parties may discuss the need for a new version of software no later than October 12, 2001, or the deal is unworkable; the need for comprehensive full indemnity or the deal does not make sense to them; or a limitation of no more than five million dollars in development expenses, or the deal is off, etc. The parties are not trying to close a deal or definitively determine the details. Rather, they are merely trying to determine if the requirements, interests, and desires of the companies overlap to some workable extent where a definitive and detailed final deal is possible. The theory is that it would be unfortunate to spend six months discussing every detail of support, warranty, delivery, licensing, indemnity, IP ownership, and other terms and conditions of a large form contract or custom contract, only to find that the whole deal falls apart because the resulting price is four times what the other party reasonably expected. To quickly determine the chance of success or failure of a high level proposal, the companies generally will try to reduce the array of choices from an infinite range of combinations to a window of more finite and predictable possibilities. If common ground cannot be located within the reduced issues, it is time to move on to the next opportunity or potential partner with minimal loss of resources and time. If the reduction of issues occurs in a mutually acceptable manner, the LOI may be used to fix a stake in the \*196 ground and allow both parties to move on to final negotiations with more confidence that a successful outcome will be obtained.

However, although an LOI represents a stronger likelihood of being able to close a deal between the parties given the current situation, it does not ensure successful execution of a final contract. Sometimes, what was first assumed to be an unimportant detail can be a deal-breaker a few weeks or months later. Assuming that failed negotiations still may result, an executive may use the same LOI to reduce his assumption of risk or to reduce uncertainty in the outcome, should the deal fall apart. Examples of such mechanisms include: defining the applicable law for the LOI and the final contract; capping the amount of damages and the types of damages to which the parties are exposed in this preliminary stage; and removing avenues for creation of contracts by certain means (address oral modification, performance, reliance, etc.).

In addition, deals that go bad are rarely an immediate surprise. They usually begin to show signs of failing long before final failure actually occurs. In these cases, where problems are apparent but not clearly out in the open as of yet, the LOI negotiation can be used to flush out these issues to enable a quick go or no-go decision before significant resources are committed. As an example, assume that the other party is providing you with third-party software, but you believe that the other party may not have a right to sublicense the code to you with all the rights you need. You may place in a binding portion of the LOI a clause that the other party warrants that he has full authority through the third party to license the code to you for enumerated purposes, and that he agrees to make this same warranty in the final agreement. Even if the other party eventually does not sign this provision, asking for this warranty at the LOI stage should provoke a revealing discussion on that issue. This may allow you to gauge the chance of success or failure in the final negotiation far in advance of the initiation of the detailed negotiation.

Therefore, while the execution of an LOI before a final contract may add a small delay into the negotiation process, it may go a long way toward quickly weeding out deals doomed to failure before significant expenditure in time and resources is made. In addition, LOIs may be used strategically to limit risk for subsequent negotiations, create certainty in the future direction of the transaction, and flush out important issues for early deliberation and resolution.

#### **IV. What Makes an LOI Binding or Non-Binding?<sup>26</sup>**

When determining whether or not all or a portion of an LOI is binding upon one or more parties, courts generally consider many factors, with a primary component being the intent of the parties to contract. For LOIs, an analysis akin to a balancing test using several factors generally is used in an attempt to achieve an equitable outcome. Usually, no one factor is dispositive in and of itself, but some \*197 factors are generally given much more weight than others. The following sub-sections introduce and analyze nine common factors considered by most, if not all, state courts, including: (1) intent to contract or lack thereof;<sup>27</sup> (2) presence or lack of critical open terms in the LOI; (3) the definiteness, specificity, or lack of such qualities in the terms that are present in the LOI; (4) presence of an expiration date within the LOI and what this implies; (5) reference to the need for further negotiation or a subsequent final agreement; (6) presence, satisfaction, or lack of conditions precedent; (7) evidence of course of conduct between the parties or industry custom; (8) presence of consideration or lack thereof; and (9) performance, detrimental reliance, or absence thereof. Through careful analysis of the following factors, an attorney or businessperson should be able to draft an LOI that is very likely to be found binding, non-binding, or semi-binding in a manner that is much more predictable and risk free.

## A. Intent of the Parties

“The primary objective in interpreting a contract is to ascertain the intent of the parties and to give effect to those intentions.”<sup>28</sup> As this quote clearly suggests, the most important factor considered by a court in determining whether or not an LOI is a binding contract, a non-binding writing, or a semi-binding agreement is the parties’ intent.<sup>29</sup> *Omnitech International, Inc. v. The Clorox Co.*<sup>30</sup> sets forth a common tenant of contract/LOI construction and interpretation, which is that when the words of the LOI are clear and explicit and lead to no absurd consequences, generally no further interpretation or extrinsic evidence is needed by the court in order to determine the parties’ intent.<sup>31</sup> In the case where intent is clear, the courts will bind the parties in accordance with their clear and express intentions as set forth in the LOI.<sup>32</sup> Therefore, it is very important for an LOI to expressly set forth \*198 what is and what is not binding upon the parties in a clear and explicit manner if risk and uncertainty are to be removed from that transaction.<sup>33</sup> If a clear and concise statement of intent is not provided in the LOI, courts may create new contractual obligations by looking outside of the four corners of the contract to extrinsic evidence that may better reveal the intent between the parties; or determine that a term in the agreement that the parties thought was clearly binding in the LOI is not binding at all.<sup>34</sup> Opening the door to extrinsic evidence such as oral conversations between executives, purchase orders, marketing literature, e-mails, letters, and other items is almost certain to result in surprising and uncomfortable results for one or many of the parties involved.

In *Fru-Con Construction Corp. v. KFX Inc.*,<sup>35</sup> the Federal Circuit’s interpretation of the binding effect of portions of an LOI turned largely on the intent of the parties.<sup>36</sup> The court found that the parties clearly expressed in the LOI their intent that the only compensation to Fru-Con for its services under the LOI was shares of stock. In addition, the court determined that the parties clearly expressed an intent that if financing for the venture was not obtained then no further obligations applied. In a manner similar to *Omnitech*, the Fru-Con court stated that it did not have to look at extrinsic evidence to discern the parties’ intent, since the intent of the parties was so clear from the LOI.<sup>37</sup> Therefore, clearly setting forth the intent of the parties in the LOI is a good way to avoid forcing a court into looking at extrinsic evidence that may result in an unexpected interpretation of the intentions of one or more parties.

In addition, a party must be careful about being silent with respect to important deal-breaker or deal-maker material in the LOI. Silence is likely to be construed as a lack of intent to be bound by that material when the material is not an essential open term. For example, in *Teachers Insurance and Annuity Association of American v. Tribune Co.*,<sup>38</sup> the parties litigated, in part, over whether or not their LOI was or was not contingent upon the defendant being able to \*199 account for its finances in a particular manner.<sup>39</sup> This important aspect of the deal was not expressly set forth in the LOI, and the court found its absence dispositive, thus, that obligation was found not to be binding upon the parties.<sup>40</sup> Unlike open terms that are essential and must be enforced by the court to make a deal sound (e.g., price, quantity, and method of delivery), some terms in an agreement are non-essential or optional. Therefore, silence regarding some critical, but non-essential, element(s) in an LOI is likely to ensure a finding of a lack of intent to be bound regarding that element(s).

*Omnitech* contains another example of silence regarding non-essential material. *Omnitech* sought via a lawsuit to force Clorox to purchase its company.<sup>41</sup> *Omnitech* also sought to bind Clorox to non-competition terms in the event Clorox did not purchase *Omnitech*.<sup>42</sup> In both cases, the court found that the parties were clear in their intentions not to be bound by covenants not to compete and obligations to engage in a purchase of a business. The court reasoned that such terms were not the intent of the parties since there was an absence of any such discussion in the LOI. Therefore, due at least in part to the LOI’s silence on these matters, no intent to be bound by these obligations was found by the court, and, more importantly, extrinsic evidence (i.e., oral conversations) between *Omnitech* and Clorox executives that seemed to indicate an opposite intent was given no weight.<sup>43</sup>

*Fru-Con* also followed this line of reasoning by refusing to interpret silence in the LOI as ambiguity that would trigger an investigation into extrinsic evidence in search of additional intent.<sup>44</sup> In *Fru-Con*, the court found that the LOI lacked any type of non-disclosure agreement (NDA) discussion and that this meant that the parties were not intending to be bound by any such terms. Due to this silence, the court refused to enforce any confidentiality terms on the parties that were in dispute in the suit.

In summary, important but non-essential material and the intent of the parties should be expressly set forth in the LOI. Since silence on non-essential material usually will not result in a court looking to external evidence to find intent, if a specific term or condition is important for subsequent negotiation or performance \*200 under the LOI, it should be expressly set forth in the LOI to reduce risk and uncertainty. In addition, once a binding term is expressly set forth in the LOI, it is important to make sure it is completely clear and explicit, so that no contrary extrinsic evidence of intent will alter or add to the binding

effects of the LOI. A clear and express statement of intent in the LOI may avoid unexpected court holdings that can result when extrinsic evidence must be considered.<sup>45</sup>

## **B. Presence of Critical Open Terms**

A common position by parties in an LOI enforcement action is that the LOI cannot be enforced because it contains too many open terms and conditions.<sup>46</sup> Courts generally agree that if a contract fails to include agreement on the basic terms of prime importance, the LOI can be considered a nullity.<sup>47</sup> However, it is easy for even a one-page LOI to address all of the material issues for a transaction, and courts generally are reluctant to let a missing essential or material term void an agreement.<sup>48</sup> For example, a sale of goods needs only an adequate description of the subject matter to be sold and of the quantity of the goods to be sold.<sup>49</sup> Even a sales price can be a vague and ambiguous term and still render enforceable a sale of goods contemplated in an LOI. Therefore, most courts are not persuaded by the mere number of open terms in the LOI<sup>50</sup> as much as they are persuaded by the important content that was left open and the intent of the parties as determined through analysis of that missing content.<sup>51</sup>

**\*201** As a sale of goods example, if an LOI were drafted to refer to the goods to be sold as “some widget having acceptable performance to both parties” or if the LOI worded the quantity as “an amount to be agreed upon by the party in a final contract,” then a good argument could be made for nullifying the LOI or making it non-binding due to the presence of critical open terms. Open-terms arguments generally are less persuasive in LOI situations where the very nature of an LOI document ensures that open terms will be present.<sup>52</sup> If there were no open terms at all in the LOI, the parties would not need an LOI that contemplated future negotiation, and the parties would instead immediately execute the formal and final agreement.

In some cases, the court struggles with the issue of open terms.<sup>53</sup> This was the case in *Teachers*, where the court noted that the existence of a substantial number of open terms or the lack of fundamental terms could leave an LOI too fragmentary to “sustain binding legal obligation.”<sup>54</sup> The plaintiff argued that the open terms in this particular agreement were so minor in economic significance that they should be ignored, and the court eventually agreed.<sup>55</sup>

Additionally, while the presence of open terms may be used to argue that no portion of the LOI should be found to be enforceable, the lack of critical open terms (i.e., a complete and detailed LOI) may not ensure that the LOI is binding in all cases.<sup>56</sup> As discussed previously, the inquiry as to whether or not an LOI is binding generally takes the form of a balancing test with the intent of the parties being a very important factor.<sup>57</sup> Therefore, even if all critical terms of the agreement are set forth with definiteness in the LOI, a clear expression of intent in the LOI that the parties did not desire to be bound by those definite terms usually will ensure that the LOI is not found to be binding.<sup>58</sup> In general, a clear statement of intent set forth in the LOI by the parties may render the presence or lack of open **\*202** terms moot, but the presence or lack of open terms may become pivotal in a situation where intent is not adequately or expressly set forth in the LOI.

## **C. Definiteness and the Presence of Tenuous Language**

Regarding the requirement of definiteness, when drafting an LOI that is to be partly binding and partly non-binding, the attorney must operate in a “bipolar” manner. It is to the parties’ benefit to draft terms that they want to be non-binding in a very indefinite and tenuous manner.<sup>59</sup> Conversely, it is to the parties’ benefit to draft the terms that they want to be binding in a very definite and concise manner. Definite, concise, and unambiguous terms, are more likely to be given legally binding effect than ambiguous terms in the LOI absent an express intent that those terms not be binding.<sup>60</sup> Therefore, when considered in conjunction with the same facts, a term that states “Party A intends to develop and manufacture a new microprocessor that operates in accordance with a mutually agreeable specification where delivery of such product to Party B preferably will occur within the calendar year 2001 and at a reasonable price” is more likely to be non-binding than “Party A agrees to sell an 800MHz version of the Pentium III to Party B made via the Party’s current 0.25 micron process using copper interconnects where delivery of functional sample product to Party B shall be on or before Jan. 01, 2001, for \$136.14 each.”

In fact, courts are less sure of themselves when they have to resort to extrinsic evidence to “manufacture” a contract for the parties. It is much easier for a judge or jury to sleep at night when they hold a party’s feet to the fire over its own signed, carefully-considered, concise, and unambiguous language. In the case of *Fru-Con*, the court found that the binding portions of the LOI contained exact financials with no ambiguity.<sup>61</sup> Time periods in *Fru-Con*’s LOI were definitively set out and left nothing to speculation.<sup>62</sup> The obligations and responsibilities of the parties were fully set forth with no possibility for

conflicting reasonable \*203 interpretations.<sup>63</sup> In Omnitech, the court was swayed by the LOI's use of tenuous language such as "data that may be generated."<sup>64</sup> Therefore, when drafting non-binding portions of the LOI, the parties should use fewer exact and complete details. Instead, tenuous language should be used whenever possible to show a lack of intent to be bound while simultaneously giving very little information to be bound to if such intent were found. Such ambiguity and lack of definitiveness should come naturally in non-binding portions, since such non-binding portions should contain the material that the parties have yet to fully discuss or cannot agree on in detail. If the parties are too definite and complete as to all the details, they should probably skip the LOI and move directly to the complete and binding formal contract to save time and further reduce risk.

As a general rule, contracts for the sale of goods will not fail for indefiniteness so long as terms are included that cover quantity and a description of the goods to be sold.<sup>65</sup> However, in cases where the indefiniteness is due to a lack of agreement between the parties, such as might be the case in the context of an LOI, the result is likely to be different.

Tenuous or not, if a crystal clear paragraph in an LOI was followed by an express statement that said "our intent is that this paragraph be wholly non-binding," it is unlikely that the court will use the definiteness of the language to overcome the parties' obvious lack in intent to contract. However, in many LOIs, it is difficult to determine exactly what the non-binding disclaimer meant to encompass (e.g., whether it was all or part of the document, sentence, or paragraph). Therefore, ambiguous and tenuously-worded terms are more likely to be found non-binding in the event that the express intent of the parties is not clearly set forth in the LOI.

#### **D. Express LOI Term or Expiration Date or a Limited Duration on Certain Terms**

The most proper purpose of an LOI is to set forth basic terms in order to enable the parties to negotiate a transaction over a future period of time. There are few deals that cannot be negotiated to completion within a few months to a year. Therefore, the good faith negotiation period set forth in the LOI should be limited to a short duration in a binding manner.<sup>66</sup> However, in a binding section of the \*204 LOI, it is important make sure that the clauses that need to survive, such as disclaimers and choice of law, do survive, so that risk reduction is maintained even after termination or expiration of the LOI. If nothing else, the express termination of an LOI after a short and well-defined negotiation time period would limit the risk, damages, or obligations on the parties should the LOI be found by a court to be a binding contract. In addition, an express short life in an LOI may go a long way to support a court's reasoning that the LOI was not intended to be a binding contract. For example, a joint development agreement to create some highly complex technology that could not possibly be accomplished in the two month time period set in the LOI could make it clear that the LOI is not intended to be the final agreement.

#### **E. Reference to Need for Further Agreement or Subsequent Negotiation**

When deciding whether or not an LOI, or a portion of an LOI, is binding, a court will place some emphasis on whether the parties expressly contemplated a need for further discussion or negotiations or expressly indicated that a final and definitive contract would be executed.<sup>67</sup> If the parties reference such a future effort or desire, the court is much more likely to interpret the LOI as not complete or binding.<sup>68</sup> However, an LOI that appears as though it is the final document or \*205 arrangement that requires no more negotiation or agreement is likely to be interpreted as being a binding contract between the parties.<sup>69</sup>

In Fru-Con, the LOI repeatedly referenced the need for subsequent negotiations and the execution of three more agreements before the deal could be completed.<sup>70</sup> Fru-Con indicates that it does not hurt to set forth in multiple locations the condition that a future agreement is necessary. Such statements within the LOI assisted the Fru-Con court in determining that portions of the LOI were not binding. In Arcadian Phosphates, Inc. v. Arcadian Corp.,<sup>71</sup> the court found that the preliminary memorandums--or LOIs-- contemplated a subsequent sales agreement that was never completed.<sup>72</sup> Since the document contemplated further negotiations followed by the execution of a sales agreement, the court found that the LOI was not intended to be binding upon the parties.<sup>73</sup>

In Teachers, the court approached the issue from a slightly different point of view. The court reasoned that a preliminary agreement contemplating further negotiations could not be binding as to the terms of the final anticipated agreement but could be binding as to the requirement to negotiate to reach that agreement in good faith.<sup>74</sup> Nonetheless, if the parties do not want to be bound until a future formal contract is executed between them, such a statement should be made in the LOI.

## **\*206 F. Use of Conditions Precedent in LOIs**

In many situations, the parties agree that a deal can be done only subject to certain conditions or that a deal cannot be done if a certain event occurs.<sup>75</sup> It is a good idea to set forth the highly likely and important “deal-maker” or “deal-breaker” conditions in the LOI to avoid any future misunderstandings or creations of false expectations.<sup>76</sup> As an example, in Fru-Con, the parties anticipated that their entire transaction would not make sense if one of their businesses could not obtain proper financing in a specific sixty-day window.<sup>77</sup> This condition was set forth in the LOI.<sup>78</sup> When the condition was not satisfied, the deal collapsed<sup>79</sup> for a reason that should not have surprised either party. The well-drafted condition precedent served its purpose very well and protected the defendant from future obligations and liabilities. In Teachers, the defendant found out that a failure to set forth an important condition precedent in writing in the LOI created a strong presumption, which the defendant could not overcome, that the condition precedent was not part of the deal.<sup>80</sup> A similar problem arose in Arcadian, where the parties first agreed that Arcadia would own 20% of a new company, then orally lowered the ownership interest to 5%, and then wound up litigating largely over whether a majority interest should be granted to Arcadia.<sup>81</sup> If this issue was important enough to litigate, it should have been included in an express condition precedent in the LOI or should have been limited to a working range of negotiation with an attached good faith obligation to negotiate within that range. It is important that conditions precedent that are material to the transaction be considered carefully and placed expressly within the LOI whenever appropriate.

It is also important to note that lack of satisfaction of conditions precedent may not trump an express indication that the parties intended the LOI to be binding \*207 or that the parties are bound to good faith negotiation.<sup>82</sup> In these cases, the court is likely to view the express intent to be bound to be more influential than the lack of satisfaction of one or more ancillary conditions precedent. In addition, the lack of satisfaction of a condition precedent will not let a party bound to an obligation of good faith negotiation walk away from the deal without a good faith attempt to satisfy the condition precedent. In Teachers, the court found that the fact that the LOI expressly stated that the agreement was “subject to . . . the preparation, execution, and delivery of legal documentation satisfactory to the company”<sup>83</sup> and did not allow defendant to walk away from the deal without trying to satisfy that particular condition or to walk away from the deal by claiming lack of satisfaction of other conditions not set forth in the LOI.

The Teachers court also found that the required approval of the Board of Directors as a condition precedent within the LOI was not dispositive.<sup>84</sup> Although these clauses were common in the industry in preliminary agreements, the court found that they could “not be considered in isolation.”<sup>85</sup> The court noted that these clauses were not “incompatible with an intention to be bound” when there was a clear acknowledgment that there existed a binding agreement.<sup>86</sup>

In Rennick v. O.P.T.I.O.N. Care, Inc.,<sup>87</sup> the express requirement of approval by the Board of Directors argued against finding the agreement binding, especially when compared with other express language in the document noting its preliminary nature.<sup>88</sup> Similarly, in A/S Apothekernes Laboratorium for Specialpræparater v. IMC Chemical Group, Inc., the Seventh Circuit came to a nearly identical conclusion regarding an express reservation of “unlimited discretion” to the Board of Directors to “either accept or reject the deal.”<sup>89</sup>

Typical conditions precedent include approval by corporate authorities (e.g., the board of directors),<sup>90</sup> the obtaining of appropriate financials,<sup>91</sup> or approval of general counsel.<sup>92</sup> Other conditions precedent might include that (1) a specific \*208 standard be approved by a governing body; (2) a certain stock price be obtained; and (3) another company develops and ships a specific product to the market. The list of potential conditions precedent is fact specific and endless. It is important for the executives and counsel to carefully consider and identify those few foreseeable and very important conditions that either make or break the deal and to determine the likelihood of their occurrence. The deal-makers and/or deal-breakers that are crucial, foreseeable, and likely to emerge should be included in the LOI to avoid any misunderstandings and future surprises.<sup>93</sup>

## **G. Industry Custom/Course of Conduct**

While industry custom and course of conduct arguments are less likely to be found in the case law, they were still present to some degree.<sup>94</sup> These arguments take basically one of two forms. The first is that the entire market or all transactions of this type are always finally consummated with an informal LOI, therefore the LOI should be binding.<sup>95</sup> In the second form, the argument is that the two parties in a suit always did deals in an informal manner with an LOI as the final instrument, therefore the particular LOI being litigated should be binding. In Teachers, the court lent some credence to the fact that the

lending industry did conduct some business with binding informal agreement such as LOIs.<sup>96</sup>

The best way to avoid the first type of argument is to expressly state in the LOI that it is not binding when this may be contrary to ordinary business practice in the industry. To counter the second argument, it would help not to set bad precedent. If you do not want to be bound by an LOI, do not use similar or identical LOI's as binding instruments with the opposing party or even other suppliers, customers, and associates that are aligned with you and unlikely to ever be problematic.

## **\*209 H. Consideration**

A common tenant of contract law is that a contract must have some form of consideration. While state law may differ some, the law regarding consideration seems to be relatively consistent across the states. Specifically, as stated in Fru-Con, a binding promise of one party, even if the other party never benefits from or requests the material promised, is enough to render valid consideration.<sup>97</sup> Consideration may be any detriment incurred by the promisee or a benefit to the promisor. It seems that a semi-binding LOI that only sets forth the very important choice of law provision or disclaimer of certain damages in a binding manner on both parties may be enough "boilerplate" consideration on the part of the parties to uphold the binding provisions on a theory of valid consideration. Note that once some consideration is found, the adequacy, fairness, or extent of the consideration generally is not a proper subject for judicial scrutiny.<sup>98</sup> In other words, in the U.S., the freedom to contract is a strong tenant in contract law.<sup>99</sup> Note that if consideration cannot be identified in an LOI that was intended to be binding or intended to be semi-binding, a court may determine that the LOI was not a binding agreement.<sup>100</sup>

### **I. Performance, Promissory Estoppel, or Detrimental Reliance**

Common arguments made to support that an LOI is binding are that one party, that detrimentally relied on the LOI, was involved in promissory estoppel, performed under the LOI, or partially performed under the LOI.<sup>101</sup> It is even possible to find reliance on an LOI in the absence of consideration. Courts generally consider that a non-binding LOI is executed in anticipation of future performance or action. For example, the court in Teachers stated: "A party's partial performance does not necessarily indicate a belief that the other side is bound. A party may make some partial performance merely to further the \*210 likelihood of consummation of a transaction it considers advantageous."<sup>102</sup> Two ways of addressing the doctrines of partial performance and detrimental reliance when drafting the LOI to obtain the desired outcome. The terms in the LOI should ensure that (1) performance or reliance that is natural under the LOI or that is intended or required to satisfy conditions precedents under the LOI does not render obligations beyond those intended; and (2) unintended performance on behalf of a party cannot be argued on its behalf to render some or all of the LOI binding.

One method to address these doctrines is to state expressly in the LOI that both parties agree that all costs, performance, oral promises, reliance, and similar activities based thereon under the LOI are borne by the party affected or relying on that activity at its own risk. In a subtler method, consideration that is present in the LOI to support the binding portions of the LOI can be tied to the expected performance or reliance under the LOI. In this case, an argument that the performance or reliance should somehow receive more benefit than that set forth expressly in the LOI flies directly in the face of the bargained-for exchange. As an example, in Fru-Con, Fru-Con began work to support fuel plants under an LOI at an expense of millions of dollars.<sup>103</sup> Since the LOI made clear that such performance was only for the consideration due under the LOI (i.e., the payment of 1.33% of stock per one million invested), Fru-Con was not entitled to other consideration or benefit due to its performance.<sup>104</sup> Any other holding would have altered the bargained-for exchange agreed upon by the parties.

Similar to partial performance, an argument of detrimental reliance was made in Omnitech.<sup>105</sup> The Omnitech court stated the well-known principle that an action in reliance requires (i) a promise made (ii) by one who knows or has reason to know (iii) that the promise will induce the other to rely (iv) to his detriment (v) provided the reliance is reasonable.<sup>106</sup> The Omnitech LOI defeated the claim of reliance, because it made reliance unreasonable as a matter of law using an integration and merger clause.<sup>107</sup> Even if integration clauses are not present in the LOI or are unenforceable in a particular state, it is always advantageous to provide an express statement in the LOI where each party assumes the risk of its reliance, negotiations, or performance.

**\*211** Teachers provides an example where partial performance prevailed, at least to a limited extent, in supporting a holding that the LOI was binding. In Teachers, the plaintiff set aside a substantial portion of money in hopes that a loan arrangement would be honored by the defendant per the terms and conditions of the binding LOI.<sup>108</sup> The lack of an express tying of

consideration to specific performance or reliance; the failure to fully integrate and merge the LOI; and the failure to render the reliance unreasonable as a matter of law resulted in partial performance being a viable argument for the plaintiff in Teachers.<sup>109</sup>

Some conditions precedent in an LOI may either imply, require by their nature, or expressly state that a party must perform some action or forbearance. This action or forbearance may result in lost opportunity, lost profit, costs, etc. In such a case, it is important to consider stating in the LOI that performance or forbearance in order to satisfy the conditions precedent will not change the non-binding nature of the LOI and that the costs and losses associated with such action or inaction are borne by the respective parties. In *Budget Marketing, Inc. v. Centronics Corp.*,<sup>110</sup> oral promises and conditions precedent that resulted in performance or reliance prevented summary judgment.<sup>111</sup> Therefore, the synergy between conditions precedent, oral statements and integration clauses, and performance under an LOI should not be ignored.

In short, certain clauses or techniques in an LOI may be used to increase or decrease the chance of success of arguments based on the doctrines of detrimental reliance or partial performance in an LOI.<sup>112</sup> Courts usually will consider these reliance, performance, or estoppel arguments before rendering an opinion, so it is important to address these issues with terms in the LOI. In many cases, the issue is not whether the doctrine at issue will fail or succeed. The LOI should, to the best extent possible, slam the door on these arguments or render them effectively moot before confrontation or legal action so that expensive and time-consuming litigation is not a viable course of action.

## **V. Introduction and Discussion of a Semi-Binding LOI Template**

In Section III, several situations that give rise to the use of an LOI were discussed. An investigation of these and other situations that trigger the use of an LOI usually reveals that when an LOI is even remotely proper, it is usually in conjunction with one reoccurring situation. In this situation, the parties generally \*212 agree on something (e.g., the general framework of a transaction or a mutual desire) but either do not fully agree over all the details or have not had the time to work out all the little, yet important, terms involved in any contractual arrangement. In summary, the parties agree on a few things and agree that they need to work on a lot of other things. However, in order to justify moving forward, a party may want to stake the current realm of acceptable negotiation in the ground. This situation is perfect for the use of a semi-binding LOI.<sup>113</sup> The semi-binding LOI provides a document in which a high level agreement can be set forth, risk to a party during the continuing negotiations can be limited (in case negotiations fail to reach a binding final agreement), and subsequent negotiations can be narrowed in scope in order to improve negotiation efficiency. The following sections set forth what terms and language should be contained in a semi-binding LOI.

### **A. General Terms<sup>114</sup>**

Setting forth the general terms to be found in the final agreement is one of the proper uses of an LOI. However, these terms are preliminary at the LOI stage and not sufficiently defined. Having a section in the LOI that is not binding but does discuss the general framework of the anticipated deal is a way to put a stake in the ground with respect to the expectations of subsequent good faith negotiation without obligating either party to fully comply with these preliminary terms. The parties can state what they think the final deal will encompass, such as the overall scope of the deal being discussed (buying a division, licensing patents, developing new technology, etc) and what the final relationship between the parties is intended to be. Parties can include terms that are generally agreed upon, but contingent on further negotiations and resolution of details. The sections that can exist in this non-binding portion of the LOI are endless and change radically from deal to deal as a function of facts, such as client's business, technology involved, financial model used, client's specific worries, etc. Putting these agreed upon or important general terms in writing serves to provide a sort of moral obligation (or a good faith obligation) on the continuing negotiations, as neither party expects these terms to be altered significantly from the initial LOI vision. Although these terms are non-binding, it is possible that if a party completely failed to negotiate based on these terms, a court would find a lack of good faith negotiation on the part of that party.<sup>115</sup>

### **\*213 B. Binding Agreement to Negotiate in Good Faith<sup>116</sup>**

Many worldwide markets are incredibly competitive, and the loss of even six months to market may translate into a substantial loss in market share, permanent loss of IP protection, and other unfortunate consequences. In addition, it is not unexpected that, especially when the parties are competitors, many parties approach a contract negotiation with extreme

skepticism and distrust. Irrational or initial skepticism among parties can, in some cases, result in months or years of delay that creates little or no value for either party. On the other hand, such caution is understandable, since it is not unusual for a company to feign or bluff a proposition with another company in an attempt to obtain some tactical market capture, competitor time delay or distraction, or technological advantage, with no intention of ever truly pursuing the opportunity with the other entity. In most cases, an oral “trust me” is not likely to go very far between two or more parties, especially if the two parties are competitors or dealing with each other for the very first time. However, a written and binding term sheet, or an LOI that states that the parties will negotiate with each other in good faith<sup>117</sup> and mutual cooperation may help to either flush out signs of an improper motive or overcome some of a party’s distrust of the other side.<sup>118</sup> It makes at least some binding statement that “we are serious about seeing this deal come to some productive conclusion.”

Section II(A) in Appendix A is a binding portion of the LOI that states that the parties to the agreement agree to negotiate in good faith in an attempt to arrive at a final agreement that substantially fulfills the intent of the LOI. While the final agreement may never happen, in spite of a good faith attempt on both sides, such parties are now bound to put forth an honest effort to close the deal amicably. Such a good faith binding of the parties by express language in the LOI is not uncommon,<sup>119</sup> and many courts will construe that a good faith obligation exists even absent such an express statement in the LOI.<sup>120</sup> However, it is generally good \*214 legal and business practice not to rely on common law, statutes, or implication to grant rights under an agreement. Generally, it is better to expressly and clearly state in the LOI the foreseeable expectations and obligations of the parties, since surprises may be entertaining in certain circumstances, but surprises in multi-million dollar transactions tend to be less than pleasant.

### **C. Binding Choice of Law<sup>121</sup>**

The determination as to whether or not a contract has been created between parties is a state law question where the law may materially vary significantly from state to state. In addition, U.S. companies frequently will sign deals with foreign entities and the law of the foreign entity may be wholly unable to handle complex commercial or technical transactions contemplated in the LOI. In addition, the foreign government’s law may be wholly different from U.S. law and incompatible with the U.S. company’s intentions. One of the most important things the binding section of an LOI can do is establish a choice of law so that the parties have some idea as to the rules of the game.<sup>122</sup> Successfully binding the party to a stable and definite body of law goes a long way towards reducing the risk and uncertainty in an LOI agreement.

As an example, in Fru-Con, the Federal Circuit, applying federal procedural law, was faced with the task of determining the effects of a non-disclosure agreement (NDA) and trade secret misappropriation under Colorado law, whereby they had to apply Missouri law to determine if all or some of an LOI was binding, since a choice of law was not properly made in the Agreement.<sup>123</sup> Imagine all the different legal precedent and local attorneys a corporate attorney would have to consult in order to advise his client as to the likelihood of success or failure in his particular LOI legal action. In addition, think of the additional attorney’s fees that would result by having to obtain an opinion from different law offices in different states on the potential effects of the LOI. This result is clearly undesirable and can be avoided through the proper use of a binding choice of law provision in the LOI.<sup>124</sup>

\*215 In Lexington Investment Co. v. Southwest Stainless, Inc.,<sup>125</sup> a major disagreement was whether New York or Texas law and venue should apply.<sup>126</sup> The LOI, signed by the parties, contained a section that chose Texas law and contractually specified venue as Fort Bend County, Texas.<sup>127</sup> Plaintiffs filed suit in New York.<sup>128</sup> The defendants argued that the choice of law and venue selection in the LOI was binding and thus suit in New York was improper. However, the plaintiffs noted that the LOI included a paragraph that designated which sections of the LOI were binding and which sections of the LOI were not binding, and the choice of law and venue section was designated as a non-binding section.<sup>129</sup> For that reason, choice of law in this case became a major issue in litigation; and it was probably difficult to counsel the client as to chances of success or failure, since neither the law nor the court was set forth in a definitively binding manner.

Therefore, as identified in Section B of Appendix A herein, a clearly binding choice of law is highly recommended in any LOI transaction.

### **D. Binding Disclaimer of Damages and Remedy<sup>130</sup>**

Generally, a lot can go wrong with an LOI at any time. In the event that something does go wrong, the result is usually that

one party to the LOI argues in court that the other party breached or committed a tort over an LOI that at least one of the parties probably thought was not binding at all. Nuances of law such as those set forth above in Section IV of this paper will be argued. When an LOI is found binding and a party is found to have materially breached that binding agreement, a binding disclaimer of incidental and consequential damages in the LOI can go a long way to preventing an adverse holding from also becoming a crippling award of damages against that party. The disclaimer of damages is a preventive risk-reduction measure that will be well worth the effort in the LOI if the LOI is ever found to be binding to the surprise of a breaching defendant. In fact, such a disclaimer may remove a large portion of the damages associated with such an action, since actual damages may be very low for these high level LOIs. In such a case, the disclaimer of incidental and consequential damages may be a ticket to quick settlement or a way to avoid suits altogether to the general overall benefit of both parties. In addition, in order to mitigate damages assessed for direct damages, one may want to cap the entire damage liability under any circumstances (i.e. direct or indirect) in an LOI. While these disclaimers are not enforced in all jurisdictions and in all circumstances, it is better to have the opportunity to avoid such damages than have no opportunity at all. It may be very comforting in the \*216 event of a serious dispute between parties to couple this clause with a severability clause that segments all liability and damage disclaimers into separately enforced covenants and/or that sets forth that any unenforceable, illegal, unconscionable, or like clause is reformed by the court to apply as close and all completely as possible the intrinsic intent of the parties under applicable law. A disclaimer of damages is set forth in Section II(c) of Appendix A herein.

#### **E. Binding LOI Termination Date<sup>131</sup>**

When drafting an LOI, it is advisable to include a fixed termination date within a clearly binding portion of the LOI. It is also important to make the duration of the LOI very short. In fact, the LOI duration should be set to the minimal time period necessary for the parties to reasonably succeed or fail at the negotiation and execution of a definitive and wholly binding final agreement.<sup>132</sup> This limited LOI period serves two purposes. First, if the LOI is found to be a binding contract in a manner that is disconcerting to one or both parties, the damage done by the LOI will be limited if the term of that now binding agreement is of very finite duration. Second, assume that the LOI contemplates a huge development effort that will take many years to complete. If the LOI sets a very short term, say three months, it is likely that a court would conclude that this LOI could not possibly be the final agreement of the parties since it was impossible for the transaction that was contemplated to be completed within the short duration set forth by the LOI. Therefore, a short LOI duration or a well crafted and considered set of termination clauses<sup>133</sup> may go a long way to assisting a court in determining that there was no intent for the LOI to be binding upon the parties.

#### **F. Binding Integration and Written Modification Clause<sup>134</sup>**

Given the nature of LOIs and the environment in which they are used, it is highly likely that many forms of communication will be exchanged between the parties, such as negotiation, oral comments, checks, e-mail, purchase orders, and written works. In Teachers, a large portion of the dispute was based upon an apparent oral arrangement that the deal was conditioned on the availability of offset accounting for the parties.<sup>135</sup> Such disagreement could be mitigated and reliance on these oral statements could be rendered less reasonable with the presence of an integration and merger clause in the LOI requiring that all changes to the LOI be \*217 made in writing, the writing being signed by all involved parties.<sup>136</sup> It is important to reduce the risk that certain communications and negotiations may change the binding or non-binding effect of the LOI or that the LOI and/or subsequent negotiations could be construed as the final contract between the parties. To this end, it is usually a good idea for an attorney to place an integration clause and written modification clause into the binding portion of the LOI and to expressly state that the terms and conditions of the LOI are to supersede any check, e-mail, purchase order, order acknowledgment, or other unilateral commercial paperwork exchanged between the parties before and after LOI execution.

#### **G. Binding Intent Warranty<sup>137</sup>**

As was explained in Section IV.A., the intent of the parties to contract is a significant and often determinative factor in the evaluation of the binding effect of an LOI. Without a clear intent set forth in the LOI, litigation is likely, and obtaining summary judgment in the law-suit is slim.<sup>138</sup> To ensure that parties “play fair” with the LOI in the future and since intent is always difficult to ascertain (especially when one must determine a party’s intent from many years ago), it may be helpful to place an “intent warranty” into the agreement. The intent warranty states that both parties warrant they had no intent whatsoever to render the non-binding portions of LOI binding, and at the same time had the intent to bind themselves only to the terms and conditions of the binding portion of the LOI. The first thing a plaintiff will have to prove in order to

successfully litigate the LOI as a binding agreement is that there was an intent to contract. The necessary proof provided by the plaintiff will then place the plaintiff in breach of his warranty per the now-fully-binding LOI. Therefore, the intent warranty clause set forth in Appendix A is a “whip saw” provision that can further diffuse the likelihood of litigation and ensure that the parties true intent is to play by the express and intended binding and/or non-binding nature of various sections of the LOI.<sup>139</sup>

#### **\*218 H. Assumption of Risk of Performance and Reliance<sup>140</sup>**

Many times, LOIs are executed with the absolute belief that both parties will execute a final contract related to the anticipated transaction. While in this “honeymoon” phase and under high hopes, it is not unusual for one or both parties to begin performance in anticipation of final agreement or to completely rely on the LOI and incur some costs or consumption of resources in response to such reliance. Due to such performance or detrimental reliance, many plaintiffs in a breach of LOI/contract lawsuit will set forth pleadings based upon detrimental reliance or performance arguing that the existence of these facts renders the LOI binding upon the parties to some extent.<sup>141</sup> While courts historically applied doctrines such as promissory estoppel only in limited circumstances, the modern application of such theories of remedy are more commonplace today.<sup>142</sup> While many litigated fact patterns will create a small chance for the successful use of these doctrines on their face, the mere availability of these doctrines may favor a choice to litigate.<sup>143</sup> Therefore, it is prudent to state in the binding portion of the LOI that all performance or reliance by a party is a risk assumed by that party and that such doctrines will not be used to change the binding or non-binding effect intended by the LOI.

#### **I. Assumption of Costs During Subsequent Negotiation<sup>144</sup>**

Whether or not the parties intended an LOI to be an acceleration mechanism, they are usually used in that manner. In other words, once the LOI is signed, one or both of the parties are usually in the honeymoon phase and think that nothing can go wrong. So they begin to invest serious money, time, resources, and effort into the transaction contemplated in the LOI, even though the LOI is designated, in whole or in part, as non-binding. The drafter of the LOI must make sure that the risk of such expenditures and effort is borne by the proper party,<sup>145</sup> and that such expenditures cannot change the non-binding nature of certain provisions in the LOI. In some cases, a smaller company that is cash poor will rely on a larger company that is cash heavy. In such a case, it may be prudent to spell out that the larger company is to pay some set fees to the smaller company but that this payment is not to be construed in any manner whereby the non-binding affect the \*219 of agreement is compromised. Given another set of facts, it may be prudent to clearly spell out that both parties bear the cost for their own expenses and that, in the event that the final contract is never executed, assumption of the risk of such expenditures is assumed by the party making the investment. A cost clause is important, since companies can invest significant amounts of capital merely in the process of negotiating an LOI toward a signed definitive agreement.

#### **J. Binding Disclaimer of Warranty and Indemnity and Confidentiality<sup>146</sup>**

It is important to consider, for inclusion in an LOI, a provision limiting or completely eliminating certain statutory forms of warranty and certain party expectations of indemnity. In many cases, under an LOI, some beta material, initial product, services, or the like may be exchanged formally or informally between the parties. In these cases, it is important to ensure that standard warranties that may apply under the U.C.C.<sup>147</sup> or common law do not apply when there is such a desire. In addition, it is important to set forth some basic non-compete, confidentiality, non-solicit, prohibition against reverse engineering, or similar protective language in the binding portion of LOI to the extent critical personnel, key beta products, or vital trade secrets are exposed to the other party by virtue of performance under the LOI. Such clauses are commonplace and generally can be incorporated quickly into any LOI without too much trouble or consumption of time.

#### **K. Purchase Order Protection Clause and Payment Clause<sup>148</sup>**

As stated above, it is not unusual for money, beta products, confidential information, or the like to change hands in response to a non-binding or semi-binding LOI.<sup>149</sup> The money and goods likely will change hands via a check, purchase order, invoice, or similar commercial document. It is not unusual for these documents to contain terms that are in direct conflict with the LOI. Some poorly drafted LOIs may not contain an integration or merger clause or may not clearly state that such a clause is binding upon the LOI parties, whereby these commercial documents may be viewed either as the final agreement or as a

subsequent written agreement that amended the LOI. Even with a well-drafted and binding integration, written modification, or merger clause, these clauses generally allow for a subsequent signed writing to alter the agreement. To ensure that a check, purchase order, order acknowledgment, or invoice that is unilaterally sent by one party to another does not affect the binding or non-binding effects of the LOI, it is good to set forth expressly, in a binding term of the LOI, that these commercial documents will be superseded by the express terms and conditions of the LOI.

## **\*220 L. Agreement Specific Content**

Every negotiation, agreement, and transaction is different from all other agreements in some manner. It is important for an executive or attorney to identify those unique risks that must be reduced, those specific protections that must be binding, and those outcomes that are wholly unacceptable and address them in a binding manner in the LOI. For example, the viability of a deal may depend on price more than any other single contractual term. In fact, the purchasing party may care far less about indemnity, warranty, or support and decide that price is the only deal-maker or deal-breaker. In this case, if a price above \$X is wholly unacceptable, the binding portion of the LOI should bind the parties to good faith negotiation to a price less than \$X and should state as a condition precedent that if this price limitation cannot be met, in spite of good faith negotiations, all agreements are null and void.

In Fru-Con, Fru-Con learned a bitter lesson in LOI drafting to the tune of almost two million dollars in monetary loss and the loss of several of its trade secrets.<sup>150</sup> Fru-Con signed an LOI with KFX to enable Fru-Con to perform fuel plant engineering and research and development for KFX subject only to payment of a percentage of stock in a company controlled by KFX.<sup>151</sup> Fru-Con, in the process of doing the work, transferred confidential information to KFX.<sup>152</sup> The LOI mentioned nothing of non-disclosure provisions, ownership of the confidential information or the tangible media it was placed on (i.e., the report books), or of license rights and restrictions on use of such information.<sup>153</sup> KFX gave the material that Fru-Con deemed confidential to at least one other party, referred to as Harris Group.<sup>154</sup> A few years later, the working relationship between KFX and Fru-Con soured, and Fru-Con found itself in court asserting a trade secret misappropriation action against KFX due to its disclosure of information to Harris Group.<sup>155</sup> The court found that the LOI stated nothing about confidentiality or trade secret ownership and that silence in an LOI could not be construed as ambiguity that triggered a lack of intent or an assessment of extrinsic evidence.<sup>156</sup> Therefore, the court found that Fru-Con sold the trade secrets to KFX in exchange for its share of stock set forth in the LOI (which it never requested under the LOI and which was useless anyway, since the stock offered to Fru-Con by KFX was in a company that ceased to exist shortly before the lawsuit commenced).<sup>157</sup> In essence, Fru-Con lost its trade secret and almost two million dollars in the process and, in the end, had no \*221 stock or value to show for it. This situation would have been different if Fru-Con had determined that it was exchanging confidential information under the LOI during subsequent negotiations and that this exchange needed to be governed by a binding NDA clause in the LOI or in a separate, possibly referenced, NDA document. The lesson that should be learned is that an LOI should not be taken lightly. If a party needs certain specific areas of the business arrangement protected, it must identify them and ensure that there is binding effect in the LOI regarding these areas or suffer the possibility of being unprotected and financially exposed, including possibly incurring the high costs for a lawsuit.

## **M. Contract Construction and Interpretation (Contra Proferentum)<sup>158</sup>**

A very old doctrine of contract interpretation or construction states that when the contract is ambiguous and subject to different plausible interpretations, the contract should be construed against the party that drafted the contract.<sup>159</sup> Many LOIs, by their very nature, are documents that are hastily reviewed and may not be heavily negotiated. Therefore, one party usually has exclusive and entire control of the content of the document. To ensure that this unilateral control of the document is not used against that party, a statement setting forth that the contract shall not be construed against one party in favor of the other party may be appropriate. This doctrine was considered in interpretation of LOIs in Fru-Con. Fru-Con lost trade secrets and monetary compensation because it did not adequately draft binding trade secret protection or ownership provisions into its LOI.<sup>160</sup> Even with this clause present in an LOI, the drafter must be careful in drafting the other LOI clauses since the facts and inferences set forth by the LOI language, when unambiguous, still may be used again the drafter (e.g., as an admission against interest).<sup>161</sup>

## **N. Default Binding Contract Provisions<sup>162</sup>**

It is possible to write an LOI in such a manner as to make a default contract binding upon the parties if there is a failure of

good faith negotiations reaching a final or definitive agreement. This tactic is most often used in cases where there is already a contract in place and the parties desire to change the relationship in some manner but have not yet fully negotiated the specifics of the new agreement. The LOI can state that upon failure to execute a final definitive binding agreement \*222 pursuant to the LOI, the contract already in place will renew for some further period of time or that some “middle of the fairway” form agreement in an appendix to the LOI will be triggered. This way, the current status between the parties is preserved while negotiations continue, and a default deal will occur regardless of subsequent unforeseeable changes in the anticipated deal or a party’s circumstances. One must be careful when employing this tactic since the possibility of triggering a default agreement can shift the negotiation power or result in a party being enticed to drag its feet in a difficult negotiation in order to trigger more favorable default provisions in the end.

#### **O. Express Recognition of Presence of Open Terms<sup>163</sup>**

An argument that a contract is illusory or non-binding in content because it contains significant open terms is a different argument than saying an obligation to negotiate in good faith to close open terms is non-binding because of the presence of open terms. The first argument makes sense, while the second argument does not. With respect to the second argument, it is clear that open terms must be present in an LOI. If not, there would be no need for an agreement to negotiate in good faith to close open terms.<sup>164</sup> To avoid use of this second argument, an issue addressed by the court in *Teachers*,<sup>165</sup> it is reasonable to provide a clause in the binding portion of an LOI that the parties understand that open terms exist and that the parties are to negotiate in good faith in an attempt to close those open terms.

#### **P. Independent Entity Clause<sup>166</sup>**

Even if the relationship between two parties is non-binding, pursuant to an LOI, they must ensure that one of the parties does not cause a third party to act on behalf of the other party to the LOI. Press announcements may have been made and the hype thus generated may have lead someone to believe that the deal was done and that one party is somehow speaking on behalf of the other party in related matters. Therefore, it is usually a good idea to place an independent entity clause<sup>167</sup> into the agreement so that both parties are notified that they cannot act on \*223 each other’s behalf in any manner and so that no legal relationship is created between those two parties pursuant to the LOI.<sup>168</sup>

## **VI. Summary**

The use of an LOI can be very helpful in a negotiation process, and they are in fact used very often in business today. An LOI that provides the basic form of the proposed deal and a road map for further negotiations can provide real value. However, too often, LOIs are entered into for the wrong reasons and with improper intentions. The true intent of the parties is either not understood, not known, not yet negotiated, or not properly spelled out in the agreement. LOIs, whether used properly or improperly, are usually incomplete agreements and generally are vague and indefinite on many matters. A dispute arising from an improperly created LOI to resolve these problems can be an expensive and frustrating activity for all parties involved. Attorneys will find it difficult to counsel clients as to their risks in negotiation involving a poorly drafted LOI. In addition, the court will be in a difficult predicament because it has to ascertain the clouded intent of the parties at signing. After intent is determined as best as possible, the court has to fashion remedies that may not have been contemplated by the parties.

The proposed semi-binding LOI provides a number of concise provisions that protect the parties involved in the agreement from the above mentioned disadvantages while allowing the survival of the typical advantages of the LOI as used in modern business. In addition, the proposed semi-binding LOI clearly delineates provisions that are meant to be binding from those that are not. Thus, the expectations of each party are properly established. The semi-binding LOI provides broad flexibility to the contracting parties in the form of non-binding provisions, and broad protections in the form of binding provisions. This type of LOI maintains a clear and straightforward format in which contractual misunderstandings should be minimized or eliminated. If a dispute arises and the semi-binding LOI is used, a court of competent jurisdiction should have far less difficulty setting forth the basic understanding of the parties and the binding and non-binding aspects of the agreement as well as remedies thereto. The court should have no need to resort to extrinsic evidence to fill in terms or to discover the true intent of the parties. In short, the use of a semi-binding LOI, similar to the form presented in Appendix A, is the best way to make clear the LOI intentions of the parties, completely define the scope of the contemplated transaction, and make any LOI disputes shorter, less expensive, less likely to occur, and more likely to result in predictable outcomes.

**\*224 Appendix A: Model Letter of Intent**

**Letter of Intent (LOI)**

**(Non-binding Portions Subject to Final Contract)**

This LOI is executed as of the date of the last signature attached hereto (EFFECTIVE DATE), sets forth the mutual intent and limited agreement of Company X Inc. (COMPANY X) and ABC Corp. (ABC). COMPANY X and ABC may be referred to in this LOI as the "Party" or "Parties."

Whereas, ABC and COMPANY X finalize this LOI to enable the Parties to negotiate the execution of a Final Contract to co-develop and jointly manufacture widgets (TECHNOLOGY) for deployment into US markets.

This LOI sets forth two sections. Section I is a non-binding portion of this LOI that itemizes the general understanding and /or intentions of the Parties with respect to subsequent negotiation. The Parties hereby agree to negotiate in good faith, in accordance with the content of Section I, in an attempt to obtain a Final Contract substantially in accordance with this LOI. Section II contains itemized terms and conditions that the Parties agree to be bound by from the EFFECTIVE DATE of this LOI. In addition, both Parties agree that the Final Contract, if such is finally executed by the Parties, shall also set forth terms and conditions substantially similar to that provided in Section II herein.

**\*225 Section I**

This Section I is not intended to be legally binding on either Party, nor does it represent a complete summary of the contractual, material, or commercial aims of the Parties. The contents of this Section I are subject to legal and other professional advice of each Party, approval by each Party's appropriate management and/or Board, and the execution of the subsequent Final Contract.

The following points have been discussed by the parties and are to be used as a basis for negotiation of the Final Contract:

**1.0 Project Management**

1.1 ABC and COMPANY X shall each provide a project manager for the duration of the development of the TECHNOLOGY.

1.2 ABC and COMPANY X shall jointly agree on TECHNOLOGY project requirements, project plans, project schedules and acceptance criteria for the TECHNOLOGY.

**2.0 Project Finance**

2.1 ABC shall agree to support TECHNOLOGY development by an NRE payment not to exceed \$10M, and COMPANY X shall agree to reasonable royalties, not to exceed 2% of the average sales price of the software, for each unit of ABC software sold by COMPANY X to a non-ABC party for use with TECHNOLOGY. Each party intends to cover their own travel, lodging, and like expenses during development.

**3.0 COMPANY X Responsibilities**

6.1 COMPANY X desires to provide and coordinate the generation of all documentation for the TECHNOLOGY.

3.2 COMPANY X will seek to provide TECHNOLOGY trademark licenses to ABC as such are needed to market TECHNOLOGY.

#### **4.0 ABC Responsibilities**

4.1 ABC shall be responsible for assuring that the technology, when deployed, meets all regulatory, marketing, technical, and other requirements and/or certifications necessary for this product to be sold and installed in the intended market.

4.2 ABC shall perform all systems integration and field system testing of the total TECHNOLOGY created by any joint TECHNOLOGY effort.

#### **\*226 5.0 ABC and COMPANY X Joint Responsibilities**

5.1 ABC and COMPANY X shall make reasonable efforts to assist each other to correct for any identified IC, software, or system IP infringements during development.

5.2 ABC and COMPANY X intend to make mutually agreed upon joint press announcements in due course if a Final Contract is signed.

#### **6.0 Exclusivity of TECHNOLOGY**

6.1 COMPANY X grants to ABC exclusive sales of software for the TECHNOLOGY in the US, for no longer than a period of one (1) year, provided that ABC maintains a top market share position in the US throughout that duration.

#### **7.0 Development Schedule**

7.1 ABC and COMPANY X shall endeavor to meet the general following development schedule based on cooperation with each others.

1. First draft target spec for TECHNOLOGY in December of 1999.
2. A finalized target spec for the TECHNOLOGY by the end of January 2000
3. Definition of development conditions and managing of the project by the end of February 2000.
5. Technology transfer to ABC of TECHNOLOGY hardware completed by mid March 2001.
6. ABC draw up firmware and software detail design specification by mid September 2000.
7. Alpha version firmware and software for TECHNOLOGY delivered to COMPANY X by August 1, 2001.
8. Final production TECHNOLOGY totally completed by October 7, 2001.

#### **8.0 TECHNOLOGY Indemnity**

8.1 Each Party shall, per a customary indemnification clause, indemnify and hold the other Party harmless from any claims

and damages arising out of infringement of third party's intellectual property right solely by information or materials provided to the other Party by such Party in connection with the project contemplated hereunder.

## **\*227 Section II**

This Section II is intended to be legally binding on both Parties with respect to the subject matter contained herein and all matters related thereto. Both Parties agree that the contents of this Section II shall also be set forth in the Final Contract in a substantially similar form.

The following points have been agreed to by the Parties:

### **A. Agreement to Negotiate in Good Faith**

The Parties agree to negotiate in good faith, for the period set forth in Section D below, in an attempt to agree upon the terms and conditions of a written Final Contract substantially in accordance with the content set forth in Sections I and II herein.

### **B. Choice of Law**

This LOI and all matters related thereto shall be governed by, subject to, and construed only in accordance with the laws of State of New York, U.S.A, without application of its conflict of laws principles. If such Final Contract is not executed and the Parties attempted to obtain the Final Contract in good faith, then failure to enter into such Final Contract shall not give rise to any liability for either COMPANY X or ABC.

### **C. Disclaimer of Damages, Warranties, and Remedies**

IN NO EVENT SHALL EITHER PARTY BE LIABLE FOR SPECIAL, INCIDENTAL, PUNITIVE, INDIRECT, OR CONSEQUENTIAL DAMAGES ARISING FROM OR CONNECTED WITH THIS LOI. ALL TANGIBLES AND INTANGIBLES PROVIDED PER THIS LOI ARE PROVIDED "AS IS" AND THE PARTIES MAKE NO WARRANTIES, WHETHER EXPRESS, IMPLIED, STATUTORY, OR OTHERWISE, INCLUDING, WITHOUT LIMITATION, WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE. Any detrimental reliance or performance based on non-binding portions of this LOI are risks that are entirely assumed by the relying or performing Party. The Parties hereby agree that the entire liability, for a Parties that operated in good faith per Section A, shall be limited to the aggregate sum of ten thousand U.S. Dollars (\$10,000.00).

### **D. LOI Termination**

Any obligations to negotiate in accordance with the content of Section I shall terminate upon the execution of the Final Contract. If no Final Contract is executed in good faith by December 01, 2000, this LOI shall expire with Paragraphs B-G surviving termination of this LOI.

## **\*228 E. Integration and Modifications Clause**

Section II of this LOI contains the present and entire agreement of the Parties to date regarding the subject matter hereof. No verbal or oral statements, other representations by either Party, or any previous written material or communication shall in any way modify, add to, delete, or otherwise amend this LOI. The binding provisions of this Section II of this LOI supersede all previous agreement between the parties concerning the same or substantially similar subject matter of this LOI. This LOI may be changed only by a writing (e.g., Final Contract) signed by authorized representatives of the Parties to this LOI.

### **F. Intent Warranty**

The Parties represent that they have no past or present intent that the Section I, as worded in this LOI, be binding on the Parties under any circumstance other than to bind the Parties to good faith negotiation as set forth in Paragraph A above. In addition, the Parties represent that they contractually agree to the terms set forth in Section II herein.

#### **G. Assumption of Costs During Negotiation**

Each Party agrees to bear its own costs for negotiation and execution of this LOI and the Final Contract (if any).

#### **H. Issuance of Purchase Order or Order Acknowledgement**

The Parties agree that the issuance of any Purchase Order (PO), Order Acknowledgement (OA), check, invoice, or like commercial document related to the subject matter of this Agreement shall in no way modify or alter the effect, interpretation, or obligations set forth in this LOI and this LOI shall supercede any conflicting terms in those documents.

#### **I. LOI Interpretation**

This LOI is the result of negotiation between the parties. Accordingly, this Agreement shall not be construed for or against either party regardless of which party drafted this Agreement or any portion thereof.

#### **J. Relationship of Parties**

The Parties are and shall be independent contractors to one another, and nothing herein shall be deemed to cause this LOI to create an agency, partnership, or joint venture between the Parties. Nothing in this LOI shall be interpreted or construed as creating or establishing the relationship of employer between COMPANY X and ABC.

COMPANY X	ABC
Date	Date
Signature	Signature
Name	Name
Title	Title

#### **Footnotes**

<sup>a1</sup> Wilson Sonsini Goodrich & Rosati, Technology Transactions Group, Austin, Texas. B.S., Electrical Engineering, B.S., Computer Science, University of Wisconsin-Madison; J.D., University of Texas. Member of the Texas Bar. Special thanks to our summer associate Doug Edwards who performed research, drafting, and editing of this article, and Corina Ruiz, my assistant who put in significant non-billable hours on this project. In addition, special thanks to my family Melissa Witek, Jayme Witek, and Jodi Witek. Yes, our children can take the computer back now.

<sup>1</sup> Andrew R. Klein, Devil's Advocate: Salvaging the Letter of Intent, 37 Emory L.J. 139 (1988) (quoting Steven R. Volk, Senior Partner, Shearman & Sterling, New York, New York.).

<sup>2</sup> Hereinafter, collectively referred to as an LOI (Letter of Intent).

<sup>3</sup> See Deborah Sparks, Partners, Bus. Wk., October 25, 1999, at 106 (stating that a company such as Oracle may have 15,000 to 16,000 contractual alliances with other companies and noting that if these are the number of contractual deals that succeed, the total number of deals that are initially pursued, some with LOIs, must be enormous).

<sup>4</sup> See *Winston v. Mediafare Entm't Corp.*, 777 F.2d 78, 80 (2d Cir. 1985) ("Under New York law, parties are free to enter into a binding contract without memorializing their agreement in a fully executed document. This freedom to contract orally remains even if the parties contemplate a writing to evidence their agreement. In such a case, the mere intention to commit the agreement to writing will not prevent contract formation prior to execution." (citations omitted)). See also *United Magazine Co. v. Prudential Ins. Co.*, 877 F. Supp. 1076, 1081 (S.D. Ohio 1995) (noting that an oral agreement will never be disposed of on summary judgement, since intent will always be a question of fact). Given *United*, it seems an oral LOI that is in dispute will always result in a long trial and will not be disposed of easily on summary judgment, whereby oral LOIs should be avoided if at all possible.

<sup>5</sup> In some cases, courts will consider a combination of writings or other exchanges to be an LOI. See, e.g., *Phoenix Mut. Life Ins. Co. v. Shady Grove Plaza Ltd. P'ship*, 734 F. Supp. 1181 (D. Md. 1990).

<sup>6</sup> *Teachers Ins. & Annuity Ass'n of Am. v. Tribune Co.*, 670 F. Supp. 491, 497 (S.D.N.Y. 1987) (stating that because there has been much litigation over preliminary agreements, it is difficult to generalize about their legal effect).

<sup>7</sup> See *Space Imaging Europe, Ltd. v. Space Imaging L.P.*, 38 F. Supp. 2d 326 (S.D.N.Y. 1999) (finding that an LOI was wholly nonbinding on the parties); *Flameout Design and Fabrication, Inc. v. Pennzoil Caspian Corp.*, 994 S.W.2d 830, 835-36 (Tex. App. 1999).

<sup>8</sup> *Teachers Ins. & Annuity*, 670 F. Supp. at 498 (S.D.N.Y. 1987) (noting that parties can bind themselves to an incomplete agreement in an LOI whereby they are subject to further good faith negotiations in order to complete the agreement in accordance with the blueprint set forth in the LOI).

<sup>9</sup> See *A/S Apothekernes Laboratorium for Specialpræparater v. IMC Chem.*, 873 F.2d 155, 158 (7th Cir. 1989) (noting that a party may breach an implied duty of good faith negotiations created by an LOI by "unreasonably insisting on a condition outside the scope of the parties' preliminary agreement").

<sup>10</sup> See *Fru-Con Constr. Corp. v. KFX Inc.*, 153 F.3d 1150, 1155, 47 U.S.P.Q.2d (BNA) 1930, 1934 (Fed. Cir. 1998) (reviewing a lengthy and detailed LOI and finding that only two elements in the LOI--a provision of a loan and payment for services via the grant of a percentage of stock in a joint venture--were enforceable, while all other terms in the LOI were non-binding on the parties).

<sup>11</sup> *Teachers Ins. & Annuity*, 670 F. Supp. at 499 (noting that giving legal recognition to preliminary binding commitments serves a valuable function in the marketplace, because it allows for more cost-effective progress to be made through reasonable reliance and avoids the need to wait until every last detail is fully negotiated). See also *Garner v. Boyd*, 330 F. Supp. 22, 25-26 (N.D. Tex. 1970).

<sup>12</sup> *Teachers Ins. & Annuity*, 670 F. Supp. at 498 (noting that if the parties have reached complete agreement, including the agreement to be bound, on all the issues perceived to require negotiation in an LOI, the LOI will be binding, and the final formal contract stage, though desirable, is not necessary to bind the parties to their agreement).

<sup>13</sup> See, e.g., *Chevron U.S.A. Inc. v. Martin Exploration Co.*, 447 So. 2d 469 (La. 1984) (reversing appellate court decision and reinstating district court's holding that LOI was binding, a process which took many years).

<sup>14</sup> See, e.g., *Reprosystem, B.V. v. SCM Corp.*, 727 F.2d 257, 261 (2d Cir. 1984) (A multi-million dollar deal involving the purchase of many subsidiaries and the transfer of hundreds of employees was begun with an LOI never reviewed by counsel. In this case, in addition to the loss of litigation costs, the loss of a promising business opportunity, and lost time to market, the plaintiff lost his one million dollar judgment on appeal due to intricacies in the LOI that he never bothered to have reviewed by an attorney).

<sup>15</sup> See, e.g., *American Cyanamid Co. v. Elizabeth Arden Sales Corp.*, 331 F. Supp. 597, 605 (S.D.N.Y 1971) (viewing an LOI as an irrevocable offer or a revocable offer subject to acceptance over time or on satisfaction of certain terms and conditions).

<sup>16</sup> See *Teachers Ins. & Annuity Ass'n of Am. v. Tribune Co.*, 670 F. Supp. 491 (S.D.N.Y. 1987).

<sup>17</sup> *Id.* at 497 (noting that some preliminary agreements will be held to be fully binding).

<sup>18</sup> UCC §2-312 (1977).

<sup>19</sup> UCC §§2-314, 2-315 (1977).

<sup>20</sup> Having a document interpreted against the drafting party is an established equitable doctrine called *Contra Proferentem*. Black's Pocket Law Dictionary (1996) ("In interpreting Documents, ambiguities are to be construed unfavorably against the drafter.").

<sup>21</sup> *Fru-Con Const Corp. v. KFX Inc.*, 153 F.3d 1150, 1157, 47 U.S.P.Q.2d (BNA) 1930, 1936 (Fed. Cir. 1998) (noting that Fru-Con drafted the LOI and could have included the provisions under dispute).

<sup>22</sup> *In Omnitech Int'l Inc. v. The Clorox Co.*, 11 F.3d 1316, 1326-27, 29 U.S.P.Q.2d (BNA) 1665, 1673-74 (5th Cir. 1994) (Defendant Clorox received an option to purchase plaintiff Omnitech, but the court found they were not obligated to generate market data that the letter of intent said "may be generated." The express language of the LOI did not indicate that the data would be generated, only that it "may" be generated).

<sup>23</sup> See *Lexington Inv. Co. v. Southwest Stainless*, 697 F. Supp. 139, 143 (S.D.N.Y. 1988) (noting that choice of law clauses generally will be upheld so long as they are not manifestly unjust).

<sup>24</sup> See *Omnitech Int'l*, 11 F.3d at 1326, 29 U.S.P.Q.2d at 1673 (noting that the terms of the agreement creating a express duty of good faith only applied to plaintiff Omnitech and not to defendant Clorox).

<sup>25</sup> See, e.g., *Budget Mktg., Inc. v. Centronics Corp.*, 927 F.2d 421, 423 (8th Cir. 1991) (finding that defendant Centronics issued a press release on the LOI long before a definitive agreement was executed based on the LOI).

<sup>26</sup> It should be noted that the author generally focused on Second Circuit, Fifth Circuit, Seventh Circuit, and Ninth Circuit case law for the following analysis, although case law from many sources has been cited herein.

<sup>27</sup> Note that the party's intent is a crucial factor in determining the binding effects of LOI. In fact, many of the enumerated items following intent in this list may be viewed simply as sub-points to the larger task of determining the parties' intent.

<sup>28</sup> See *Fru-Con Constr. Corp. v. KFX Inc.*, 153 F.3d 1150, 1156, 47 U.S.P.Q.2d (BNA) 1930, 1935 (Fed. Cir. 1998).

<sup>29</sup> See also *Teachers Ins. & Annuity Ass'n of Am. v. Tribune Co.*, 670 F. Supp. 491, 497 (S.D.N.Y. 1987) ("[P]rime significance attaches to the intentions of the parties and to their manifestations of intent."); *Space Imaging Europe, Ltd. v. Space Imaging L.P.*, 38 F. Supp.2d 326, 333 (S.D.N.Y. 1999) ("[T]he key is the intent of the parties, and their mutual intent to be bound."); *Winston v. Mediafare Entm't Corp.*, 777 F.2d 78, 80 (2d. Cir. 1985) ("[I]t is the intent of the parties that will determine the time of contract formation, if any."); *Ward v. PriCellular*, 1991 U.S. Dist. LEXIS 5000 (S.D.N.Y. 1991).

<sup>30</sup> 11 F.3d 1316, 29 U.S.P.Q.2d (BNA) 1665 (Fed. Cir. 1994).

<sup>31</sup> *Id.* at 1326, 29 U.S.P.Q.2d (BNA) at 1673; *Space ImagingEurope*, 38 F. Supp. 2d at 335 (finding that the parties did a poor job of identifying which terms in an LOI were enforceable and which were not enforceable, whereby the court had to investigate extrinsic evidence of intent in order to determine that the LOI was, in fact, non-binding).

<sup>32</sup> See *Teachers Ins. & Annuity Ass'n.*, 670 F. Supp. at 500 (finding that many references in the preliminary agreement--e.g., "accepted and agreed to," "our agreement to purchase," "your agreement to issue, sell and deliver," "shall become a binding agreement between us"--showed a clear intent to be bound; and finding that the intrinsic evidence of a binding contract so powerful in this case, that this intent evidence trumped conditions precedent supporting a non-binding holding, such as the approval of counsel, delivery of documents and the approval of the board); *Ward v. PriCellular*, 1991 U.S. Dist. LEXIS 5000, \*20 (holding that statements such as "the LOI will no longer be binding," "rights and obligations of LOI," "acceptance of terms and conditions contained in this LOI," and "agrees and accepted by" create doubt as to the non-binding intent of a party that will preclude summary judgment). See also *infra* Section IV.F.

<sup>33</sup> See *Arcadian Phosphates, Inc. v. Arcadian Corp.*., 884 F.2d 69, 70 (2d Cir. 1989) (finding lack of intent to contract despite bad extrinsic evidential facts that would have indicated a contract should have existed).

<sup>34</sup> See *Omnitech Int'l*, 11 F.3d 1316, 1326, 29 U.S.P.Q.2d (BNA) 1665, 1673 (Fed. Cir. 1994).

<sup>35</sup> 153 F.3d 1150, 47 U.S.P.Q.2d (BNA) 1930 (Fed. Cir. 1998).

<sup>36</sup> See *id.* at 1156, 47 U.S.P.Q.2d (BNA) at 1934. Note that since intent is the cornerstone of the analysis, some of the following sections of this article may be viewed by a court as a subset of the intent inquiry. In addition, that intent inquiry may be a very complicated multi-factor test. See *Mid-Continent Tel. Corp. v. Home Tel. Co.*, 319 F. Supp. 1176 (N.D. Miss. 1970).

<sup>37</sup> See *Fru-Con*, 153 F.3d at 1156, 47 U.S.P.Q.2d (BNA) at 1934.

<sup>38</sup> 670 F. Supp. 491 (S.D.N.Y. 1987).

<sup>39</sup> *Id.* at 504-505 (finding that regardless of oral discussion, the signed LOI did not provide for conditions of availability of offset accounting, even though defendant argued that this condition was always understood to be a condition of the agreement, and holding that these conditions did not apply).

<sup>40</sup> *Id.* at 504 (noting that regardless of oral agreement, signed LOI did not contain condition at issue, therefore, the parties should not be bound to such a condition precedent).

<sup>41</sup> See *Omnitech Int'l, Inc. v. The Clorox Co.*, 11 F.3d 1316, 1327, 29 U.S.P.Q.2d (BNA) 1665, 1673 (Fed. Cir. 1994).

<sup>42</sup> See *id.* at 1326, 29 U.S.P.Q.2d (BNA) at 1674.

<sup>43</sup> See *id.* at 1328-1329, 29 U.S.P.Q.2d (BNA) at 1668-69.

<sup>44</sup> See *Fru-Con Constr. Corp. v. KFX Inc.*, 153 F.3d 1150, 47 U.S.P.Q.2d (BNA) 1930, 1935 (Fed. Cir. 1998). But see *Shann v. Dunk*, 84 F.3d 73, 80 (2d Cir. 1996) (finding LOI sufficiently ambiguous to justify consideration of extrinsic evidence).

<sup>45</sup> See *Mid-Continent Tel. Corp. v. Home Tel. Co.*, 319 F. Supp. 1176, 1189 (N.D. Miss. 1970) (holding that extrinsic evidence and external factors are to be considered in determining intent of the parties when the agreement itself is ambiguous and clear evidence otherwise fails to show a positive intention of the parties).

<sup>46</sup> Teachers Ins. & Annuity Ass'n of Am. v. Tribune Co., 670 F. Supp. 491, 501 (S.D.N.Y. 1987) (citing defendant's contention that the commitment letter agreement included so many open terms that it could not be deemed a binding contract). See also Winston v. Mediafare Entm't Corp., 777 F.2d 78, 82 (2d Cir. 1985) (providing a different way of stating this argument in which, if nothing is left to negotiate in the LOI (i.e., no open terms), the LOI should be construed to be a binding agreement); R.G. Group, Inc. v. The Horn & Hardart Co., 751 F.2d 69, 76-77 (2d Cir. 1984).

<sup>47</sup> See Adjustrite Sys., Inc. v. GAB Bus. Servs., Inc., 145 F.3d 543, 547 (2d Cir. 1998) (noting that the district court decided that too many material terms were missing from the agreement to agree and that even if the parties did express some intent to be bound, there were not enough terms memorialized between the parties for the court to find a binding contract).

<sup>48</sup> See Shann v. Dunk, 84 F.3d 73, 82 (2d Cir. 1996) (holding that voiding an agreement for absence of an essential term is a step courts should take only in rare and extreme circumstances).

<sup>49</sup> See U.C.C. §2-201 cmt. 1, explaining that in the formation of a contract for the sale of goods, "the only term which must appear is the quantity term." Obviously, a quantity term is useless without a description of the goods to be purchased, so this term is also considered a necessity.

<sup>50</sup> Teachers Ins. & Annuity Ass'n of Am. v. Tribune Co., 670 F. Supp. at 501 (noting that the fact that countless pages of relatively conventional minor clauses remain to be negotiated does not render the agreement unenforceable).

<sup>51</sup> Id. (finding that the two page term sheet attached to the commitment letter covered all of the essential terms whereby a binding agreement could be found). See also Mid-Continent Tel. Corp. v. Home Tel. Co., 319 F. Supp. 1176, 1187 (N.D. Miss. 1970).

<sup>52</sup> Teachers Ins. & Annuity Ass'n, 670 F. Supp. at 497, 502 (explaining that if the question is whether a preliminary expression of commitment was intended to bind the parties to negotiate the open terms in good faith, the mere fact of the existence of open terms is unconvincing). For this reason, it may not be a bad idea to place a short clause in the binding portion of an LOI that sets forth that both parties recognize the existence of open terms and that by the very nature of a preliminary LOI, these open terms must exist; however, their presence will not affect the obligations or affect set forth by the LOI. See *infra* Section V.O.

<sup>53</sup> See Shann v. Dunk, 84 F.3d 73, 74 (2d Cir. 1996) (reversing district court holding by finding LOI with open terms non-binding).

<sup>54</sup> Teachers Ins. & Annuity Ass'n, 670 F. Supp. at 497.

<sup>55</sup> Id. at 496.

<sup>56</sup> See Arcadian Phosphates, Inc. v. Arcadian Corp., 884 F.2d 69, 70, 73 (2d Cir. 1989) (holding LOI to be unenforceable on summary judgment despite finding that the assets to be purchased, price, times, etc. of an asset acquisition transaction were set forth in detail).

<sup>57</sup> Mid-Continent Tel. Corp. v. Home Tel. Co., 319 F. Supp. 1176, 1187 (N.D. Miss. 1970) (finding that an intent to be bound overcame an argument that certain open terms and indefiniteness existed in the agreement and stating that "a contract is not necessarily lacking in all effect merely because it expresses the idea that something is left to future agreement").

<sup>58</sup> See generally Arcadian Phosphates, 884 F.2d 69.

<sup>59</sup> E. Allan Farnsworth, *Contracts* 208-18 (2d. ed. 1990); Mid-Continent Tel., 319 F. Supp. at 1187, 1192 (finding agreement binding in spite of argument that a letter of agreement was not sufficiently definite to be found to be binding and noting the need for "extended discussion" on the matter; and stating that if an LOI contains matter which will enable the court under proper rules of construction to ascertain its terms, the law favors a determination that a writing document is binding absent express intent to the

contrary).

<sup>60</sup> See *Fru-Con Constr. Corp. v. KFX Inc.*, 153 F.3d 1150, 47 U.S.P.Q.2d (BNA) 1930, 1935 (Fed. Cir. 1998). See also *Space Imaging Europe, Ltd. v. Space Imaging L.P.*, 38 F. Supp. 2d 326, 335 (S.D.N.Y. 1999) (finding that ambiguous language and intent may result in a potentially dangerous investigation and consideration of extrinsic evidence by the court); *American Cyanamid Co. v. Elizabeth Arden Sales Corp.*, 331 F. Supp. 597, 603-604 (S.D.N.Y. 1971) (allowing a detailed set of financial statements used in an acquisition to be used to conclude that the LOI was binding).

<sup>61</sup> See *Fru-Con*, 153 F.3d at 1156, 47 U.S.P.Q.2d (BNA) at 1932 (noting that plaintiff Fru-Con was to get 1.33% share of stock in the KFX defendant-controlled company for each one million dollars of services put forth by FruCon).

<sup>62</sup> See *id.* at 1153, 47 U.S.P.Q.2d (BNA) at 1932 (holding that financing for deal was to be in a specific sixty-day window or the entire arrangement contemplated under the LOI was void).

<sup>63</sup> See *id.*, 47 U.S.P.Q.2d (BNA) at 1937 (finding that detailed engineering, site investigation, preparation of permit applications, submission of specifications and purchase orders, lead times, financing obligations, and the like were set forth in clear detail in the LOI).

<sup>64</sup> See *Omnitech Int'l Inc. v. The Clorox Co.*, 11 F.3d 1327, 29 U.S.P.Q.2d (BNA) 1665, 1674 (Fed. Cir. 1994). Note that some courts split hairs over specific words when determining the level of definiteness of an agreement where single words may have a significant impact upon the court. See *Adjustrite Sys., Inc. v. GAB Bus. Servs., Inc.*, 145 F.3d 543, 549 (2d Cir. 1998) (considering single words like “proposal” versus use of “agreement,” “desires to” as opposed to more definite language such as “shall,” etc.).

<sup>65</sup> UCC §2-204(3).

<sup>66</sup> See *Arcadian Phosphates, Inc. v. Arcadian Corp.*, 884 F.2d 69, 70 (2d Cir. 1989) (discussing an LOI that contained an express period of duration).

<sup>67</sup> See *Lexington Inv. Co. v. Southwest Stainless, Inc.*, 697 F. Supp. 139, 140 (S.D.N.Y. 1988). This case is one of many cases that sets forth facts where the LOI refers to a final agreement, definitive contract, or forthcoming agreement that is to follow the LOI. This reference to a later agreement is fairly effective in ensuring that the portions of an LOI that are recited or intended to be non-binding are likely to be held to be non-binding by a court. See also *Space Imaging Europe, Ltd. v. Space Imaging L.P.*, 38 F. Supp. 2d 326 (S.D.N.Y. 1999) (discussing an LOI that referenced the need for a subsequent Regional Affiliate Agreement (RAA) before being a binding agreement); *R.G. Group, Inc. v. The Horn & Hardart Co.*, 751 F.2d 69, 75 (2d Cir. 1984) (explaining that considerable weight is placed on a party’s explicit statement that it reserves the right to be bound until a written agreement is signed and that it does not matter if such a clear signal is given in negotiation or in the LOI itself); *Winston v. Mediafare Entm't Corp.*, 777 F.2d 78, 80-81 (2d Cir. 1985) (noting that the court should consider if there exists an express reservation, either in the LOI or in communications between the parties, that no agreement be binding unless there is a subsequent writing); *Reprosystem, B.V. v. SCM Corp.*, 727 F.2d 257, 261 (2d Cir. 1984) (explaining that if the parties intend not to be bound until they have executed a formal document embodying their agreement, they will not be bound until then). However, that parties’ intent is a strong factor in determining whether the contract is binding. See *Ward v. PriCellular*, 1991 U.S. Dist. LEXIS 5000, \*12 (S.D.N.Y. 1991) (noting that the mere fact that the parties contemplate memorializing their agreement in a formal document does not prevent their informal agreement from taking effect prior to that event); *Garner v. Boyd*, 330 F. Supp. 22, 25-26 (N.D. Tex. 1970) (holding that a reference to a further agreement was not sufficient to prevent a finding that an LOI was a binding contract); *Chevron U.S.A. Inc. v. Martin Exploration Co.*, 337 So. 2d 469, 472 (La. 1984) (holding that a “forceful” argument that a subsequent agreement was contemplated was not enough to overcome the creation of a binding agreement from a preliminary agreement or preceding LOI); *Reprosystem, B.V. v. SCM Corp.*, 727 F.2d 257, 261 (2d Cir. 1984) (stating that the fact the parties state the need for a formal agreement does not prevent an agreement from being formed at the LOI stage and that emphasis must be placed on intention rather than mere form).

<sup>68</sup> See *R.G. Group*, 751 F.2d at 70 (noting that when experienced businessmen and lawyers are told explicitly and clearly that a major and complex agreement will be binding only when put in writing, they should be rather cautious about assuming anything different).

<sup>69</sup> However, that parties' intent is a strong factor in determining whether the contract is binding. See *Ward*, 1991 U.S. Dist. LEXIS at \*12 (explaining that the mere fact that the parties contemplate memorializing their agreement in a formal document does not prevent their informal agreement from taking effect prior to that event); *Garner*, 330 F. Supp. at 25-26 (holding that a reference to a further agreement was not sufficient to prevent a finding that an LOI was a binding contract); *Chevron*, 337 So. 2d at 472 (finding that a "forceful" argument that a subsequent agreement was contemplated was not enough to overcome the creation of a binding agreement from a preliminary agreement or preceding LOI); *Reposystem*, 727 F.2d at 261 (stating that the fact the parties state the need for a formal agreement does not prevent an agreement from being formed at the LOI stage and that emphasis must be placed on intention rather than mere form).

<sup>70</sup> See *Fru-Con Constr. Corp. v. KFX Inc.*, 153 F.3d 1150, 47 U.S.P.Q.2d (BNA) 1930, 1932, 1937 (Fed. Cir. 1998) (explaining that the parties contemplated the need for a Shareholder's agreement, an Engineering Procurement and Construction Contract, and an Operation and Management Agreement between the parties, without which a deal could not be completed; noting that "the Letter of Intent does express the parties' intent to negotiate contract in the future and is therefore not binding upon the parties"; and explaining why a select few terms in the LOI were found binding due to a strong finding of a mutual intent to be bound regarding these terms).

<sup>71</sup> 884 F.2d 69 (2d Cir. 1989).

<sup>72</sup> *Id.* at 72 (2d Cir. 1989) (finding that memorandum contained two references to the possibility that negotiations may fail and that a binding sales agreement needed to be completed at a later date). See also *Space Imaging Europe, Ltd. v. Space Imaging L.P.*, 38 F. Supp. 2d 326 (S.D.N.Y. 1999) (stating that the binding effect of the agreement was subject to subsequent successful negotiations related to a regional affiliate agreement and a regional operations center).

<sup>73</sup> See *Adjustrite Sys., Inc. v. GAB Bus. Servs., Inc.*, 145 F.3d 543, 547 (2d Cir. 1998) (noting that the district court found that the presence of references to employment agreements, sales agreements, and other agreements where such agreements were never executed resulted in the finding that an agreement to agree was non-binding upon the parties).

<sup>74</sup> *Teachers Ins. & Annuity Ass'n of Am. v. Tribune Co.*, 670 F. Supp. 491, 498 (S.D.N.Y. 1987).

<sup>75</sup> *Id.* at 499 (noting that there is a strong presumption against finding binding obligations in agreement that include open terms, calls for future approvals, and expresses the requirements for future preparation and execution of formal contract documents or other conditions). Be careful to note, where appropriate, the effect of the condition precedent, since courts may recognize two or more types of conditions precedent. See *Mid-Continent Tel. Corp. v. Home Tel. Co.*, 319 F. Supp. 1176, 1190 (N.D. Miss. 1970) (holding that a condition precedent may be a condition that must be performed before an LOI becomes binding or that it may be a condition that must be fulfilled before a duty to perform a specific obligation under a binding agreement arises). See also *United Magazine Co. v. Prudential Ins. Co.*, 877 F. Supp. 1076, 1080 (S.D. Ohio 1995) (suggesting that it may not be a bad idea to expressly state that important conditions precedent in your LOI are "time is of the essence").

<sup>76</sup> *Adjustrite*, 145 F.3d at 550 (holding that the condition requiring Adjustrite to obtain an extension of a critical incoming license grant in order to make a merger feasible should have been placed in the LOI in order to properly set expectations up front and reduce the likelihood of litigation).

<sup>77</sup> See *Fru-Con Constr. Corp. v. KFX Inc.*, 47 U.S.P.Q.2d (BNA) 1930, 1932 (Fed. Cir. 1998).

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> *Teachers Ins. & Annuity Ass'n.*, 670 F. Supp. at 504-05 (explaining that the condition of the availability to defendant Tribune of

offset accounting is not dispositive since it was not expressly set forth in the LOI).

81 See *Arcadian Phosphates, Inc. v. Arcadian Corp.*, 884 F.2d 69, 71 (2d Cir. 1989).

82 See *infra* Section IV.A.

83 See *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 506.

84 See *id.*, 670 F. Supp. at 500.

85 *Id.*

86 *Id.*

87 77 F.3d 309, 312 (9th Cir. 1996).

88 *Id.* at 312.

89 *A/S Apothekernes Laboratorium for Specialpræparater v. IMC Chem. Group, Inc.*, 873 F.2d 155, 156 (7th Cir. 1989).

90 See *Arcadian Phosphates, Inc. v. Arcadian Corp.*, 884 F.2d 69, 70 (2d Cir. 1989).

91 See *id.* at 70.

92 See reference numeral 8 in the semi-binding LOI for a working example of this common pair of conditions precedent. See Appendix A. See also *Teachers Ins. and Annuity Ass'n of Am. v. Tribune Co.*, 670 F. Supp. 491, 507 (S.D.N.Y. 1987) (discussing the fact that it is common for LOIs to contain a reference requiring acceptance by legal counsel before contractual binding terms and conditions are enforceable).

93 In the event that the condition precedent does not make it into the LOI, it may be beneficial, in correspondence between the parties, to have some written record of the existence and agreement on the condition precedent. See *Winston v. Mediافare Entm't Corp.*, 777 F.2d 78, 81 (2d Cir. 1985) (finding that the content of communications between counsel was sufficient to show an intent that a condition precedent was executed and to show delivery of certain agreements).

94 See, e.g., *Phoenix Mut. Life Ins. Co. v. Shady Grove Plaza Ltd. P'ship.*, 734 F. Supp. 1181, 1187-88 (D. Md. 1990).

95 See, e.g., *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 503 (considering whether or not, in the relevant business community, it is customary to accord binding force to the type of informal or preliminary agreement, such as an LOI). See also *Winston*, 777 F.2d at 80 (stating that courts may investigate, by complexity of the transaction, surrounding circumstances and facts, and type of transaction anticipated, whether transactions of this type are usually made in an informal manner, whereby a court is more likely to find and LOI binding). But see *Midtown Realty, Inc. v. Hussain*, 712 So. 2d 1249, 1252 (Fla. Dist. Ct. App. 1998) (concluding that a transaction for the sale of a gas station was so complex in its environmental issues, governmental approvals, licenses, etc., that it could not possibly have been consummated in an LOI); *Reprosystem, B.V. v. SCM Corp.*, 727 F.2d 257, 262 (2d Cir. 1984) (explaining that a transaction so complex that it involved millions of dollars in payments, transfer of thousands of employees, government approval, sale of securities, and other complexities could not possibly be expected to be completed via a short LOI).

96 Teachers Ins. & Annuity Ass'n., 670 F. Supp. at 503 (finding that the use of LOIs was "within the recognized practices of the lending industry").

97 See Fru-Con Constr. Corp. v. KFX Inc., 153 F.3d 1150, 1158, 47 U.S.P.Q.2d (BNA) 1930, 1936-37 (Fed. Cir. 1998).

98 See *id.* at 1159, 47 U.S.P.Q.2d (BNA) at 1937.

99 See *id.* at 1157, 47 U.S.P.Q.2d (BNA) at 1935 ("The policy of the law is to let parties weigh the benefits pro and con and leave them free to make whatever contract between themselves that they please. The general rule of freedom of contract includes the freedom to make a bad bargain.").

100 See Space Imaging Europe, Ltd. v. Space Imaging L.P., 38 F. Supp. 2d 326, 329, 337-38 (S.D.N.Y. 1999) (finding that the provision in suit was not supported by any identifiable consideration whereby the court determined that the provision was non-binding).

101 See, e.g., Teachers Ins. & Annuity Ass'n of Am. v. Tribune Co., 670 F. Supp. 491, 502 (S.D.N.Y. 1987); R.G. Group, Inc. v. The Horn & Hardart Co., 751 F.2d 69, 75-76 (2d Cir. 1984) (noting that a significant factor in determining the binding effect of an LOI is to determine whether one party partially performed and the other party accepted that performance); Mid-Continent Tel. Corp. v. Home Tel. Co., 319 F. Supp. 1176, 1187 (N.D. Miss. 1970) (stating that where one party begins performance, with knowledge and approval of the other, it is nearly always evidence of an intention to be bound); Reprosystem, B.V. v. SCM Corp., 727 F.2d 257, 264-265 (2d Cir. 1984); Phoenix Mut'l Life Ins. Co. v. Shady Grove Plaza Ltd. P'ship., 734 F. Supp. 1181, 1191 (D. Md. 1990); Adjustrite Sys., Inc. v. GAB Bus. Servs., Inc., 145 F.3d 543, 547 (2d Cir. 1998) (determining that proof of partial performance favored the plaintiff's assertion that an LOI be binding).

102 Teachers Ins. & Annuity Ass'n., 670 F. Supp. at 502. But see *Garner v. Boyd*, 330 F. Supp. 22, 25-26 (N.D. Tex. 1970) (stating that acts of performance by a party may persuade a court to find that an agreement exists, especially if the LOI is not clear that performance should not suggest a binding contract).

103 See Fru-Con Constr. Corp. v. KFX Inc., 153 F.3d 1150, 1154, 47 U.S.P.Q.2d (BNA) 1930, 1933 (Fed. Cir. 1998) (finding that plaintiff Fru-Con's work totaled \$1.8 million).

104 *Id.* at 1155, 47 U.S.P.Q.2d (BNA) at 1934 (finding that the LOI expressed a clear intent that the only compensation due plaintiff Fru-Con for performance was a share of stock).

105 *Omnitech Int'l, Inc. v. Clorox Co.*, 11 F.3d 1316, 1329-1330, 29 U.S.P.Q.2d (BNA) 1665, 1676 (Fed. Cir. 1994).

106 *Id.*

107 *Id.* (noting that promises made were outside the scope of the fully-integrated, written agreements between the parties and that any reliance on any such representations was unreasonable).

108 Teachers Ins. & Annuity Ass'n of Am. v. Tribune Co., 670 F. Supp. 491, 502 (S.D.N.Y. 1987) (finding that the amount available to give to borrowers was finite and was allocated by plaintiff based on the LOI).

109 *Id.* at 502 (explaining that the factor of partial performance favored plaintiff).

110 927 F.2d 421 (8th Cir. 1991).

<sup>111</sup> Id. at 423, 426-27.

<sup>112</sup> Such limitation of risk of review of performance and reliance is valuable, since many courts will consider such facts. See, e.g., *Winston v. Mediafare Ent'ment Corp.*, 777 F.2d 78, 80-81 (2d Cir. 1985) (stating that a court must look to the words and deeds of the parties and may consider partial performance to determine if a preliminary agreement is binding upon the parties).

<sup>113</sup> Semi-binding LOIs are not unheard of in the case law. See, e.g., *Fru-Con Constr. Corp. v. KFX Inc.*, 153 F.3d 1150, 1153, 47 U.S.P.Q.2d (BNA) 1930, 1932 (Fed. Cir. 1998) (involving a long and detailed LOI that stated that except for an obligation to provide a bridge loan and the right to receive shares of stock in exchange for the bridge loan, all other material was non-binding). In essence, this was a semi-binding LOI where two terms were binding and all other terms were non-binding. However, *Fru-Con* teaches that it is important to very clearly set out your intent as to what is binding and what is not binding upon the parties.

<sup>114</sup> See infra Section I of Appendix A.

<sup>115</sup> *Teachers Ins. & Annuity Ass'n.*, 670 F. Supp. at 498 (holding that parties can bind themselves to an incomplete agreement in an LOI whereby they are subject to further good faith negotiations in order to complete the agreement in accordance with the blueprint set forth in the LOI).

<sup>116</sup> See infra Section II.A. of Appendix A.

<sup>117</sup> See *Teachers Ins. & Annuity Ass'n.*, 670 F. Supp. at 499, 507 (stating that good faith bars a party from renouncing a deal without attempting to close issues, unilaterally abandoning the negotiations without cause, or insisting on conditions that do not conform to or flatly contradict the LOI). See also *Phoenix Mut. Life Ins. Co. v. Shady Grove Plaza Ltd. P'ship.*, 734 F.Supp. 1181, 1190 (D. Md. 1990) (explaining that good faith does not prohibit a party from bargaining to its own economic advantage).

<sup>118</sup> It is important to note that by stating that an agreement is binding, but not stating that the agreement is binding for good faith negotiation only opens the door to a court's interpretation as to what is binding. See, e.g., *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 498. In the case where the LOI is clear that it is non-binding, language that indicates good faith negotiation is desired (e.g., "both parties agree to cooperate fully and work judiciously in order to close an agreement") may be of no effect. This was the case in *Arcadia* as well. Therefore, one needs to make any reference to good faith negotiation binding and very clear in the LOI, or adverse consequences are possible.

<sup>119</sup> See e.g., *Fru-Con Constr. Corp. v. KFX Inc.*, 153 F.3d 1150, 1152-53, 47 U.S.P.Q.2d (BNA) 1930, 1931-32 (Fed. Cir. 1998) (noting that under an LOI, the parties agreed to negotiate in good faith for the execution of three separate agreements).

<sup>120</sup> See *A/S Apothekernes Laboratorium for Specialpræparater v. IMC Chem.*, 873 F.2d 155, 158 (7th Cir. 1989) (noting that "a number of courts, including this court, have held that terms of a letter of intent may impose an implied duty of good faith negotiation."); *In re Dino De Laurentiis and Cinematografica de law Americas, S.A.*, 174 N.E.2d 736, 736 (N.Y. 1961) (discussing the implication of good faith read into every contract and extending this doctrine to partial agreements). See also *Budget Mktg. Inc. v. Centronics Corp.*, 927 F.2d 421, 423 (8th Cir. 1991) (finding that a claim was made relying on an implied duty of good faith).

<sup>121</sup> See infra section II.B. of Appendix A.

<sup>122</sup> See *Budget Mktg.*, 927 F.2d at 424-25 (holding that appellate court could overrule district court's decision to apply Iowa law, which was based on the fact that no law was chosen in the LOI, and could apply new law).

<sup>123</sup> See *Fru-Con*, 153 F.3d at 1154, 47 U.S.P.Q.2d (BNA) at 1933-34. Lack of choice of law in an LOI is not uncommon. See, e.g., *United Magazine Co. v. Prudential Ins. Co.*, 877 F. Supp. 1076, 1080 (S.D. Ohio 1995) (deciding that New York law would apply).

<sup>124</sup> Lack of choice of law is not uncommon. See *Mid-Continent Tel. Corp. v. Home Tel. Co.*, 319 F. Supp. 1176, 1187 (N.D. Miss. 1970) (making an issue of whether the substantive law of Mississippi or Ohio applied to determine the party's rights, duties, and remedies under a letter agreement).

<sup>125</sup> 697 F Supp. 139 (S.D.N.Y. 1988).

<sup>126</sup> *Id.* at 141.

<sup>127</sup> *Id.* at 140-41.

<sup>128</sup> *Id.* at 140.

<sup>129</sup> *Id.* at 141.

<sup>130</sup> See *infra* Section II.C. of Appendix A.

<sup>131</sup> See *infra* Section II.D. of Appendix A.

<sup>132</sup> See *Space Imaging Europe, Ltd. v. Space Imaging L.P.*, 38 F. Supp. 2d 326 (S.D.N.Y. 1999) (noting that an expiration date of about ninety days was provided for in the LOI).

<sup>133</sup> See *HDA Parking Developers, Inc. v. Mount Vernon Hosp.*, 260 A.D.2d 350, 350 (N.Y. App. Div. 1999) (stating that an LOI that contains opt-out provisions that were exercised or satisfied by a party may be of some benefit if the LOI is litigated).

<sup>134</sup> See *infra* Section II.E. of Appendix A.

<sup>135</sup> *Teachers Ins. & Annuity Ass. of Am. v. Tribune Co.*, 670 F. Supp. 491, 493 (S.D.N.Y. 1987).

<sup>136</sup> See also *Arcadian Phosphates, Inc. v. Arcadian Corp.*, 884 F.2d 69, 70 (2d Cir. 1989) (finding that the facts suggested that multiple writings and oral discussions took place that clouded and diverged the expectations of the parties, whereby litigation due to discontent was progressively becoming more likely). See also *Shann v. Dunk*, 84 F.3d 73, 76 (2d Cir. 1996) (noting a missing merger clause and the fact that a lot of interaction between the parties pertained to personal liability of Shann before and after execution of the LOI, thereby enabling the court to investigate this evidence in order to: (1) determine not only the terms of the LOI; but (2) determine whether or not the LOI was even binding in the first place (i.e., the liability of the individual was deemed to be an essential term of the LOI)). See also *Budget Mktg., Inc. v. Centronics Corp.*, 927 F.2d 421, 426-27 (8th Cir. 1991).

<sup>137</sup> See *infra* Section II.F. of Appendix A.

<sup>138</sup> *United Magazine Co. v. Prudential Ins. Co.*, 877 F. Supp. 1076, 1082 (S.D. Ohio 1995) (finding that contract did not set forth an express intent whereby an analysis of the facts and circumstances surrounding the LOI execution and performance was needed by a trier of fact whereby summary judgement was denied).

<sup>139</sup> *Reprosystem, B.V. v. SCM Corp.*, 727 F.2d 257, 261 (2d Cir. 1984) (stating that for an LOI not to be binding, one must show either: (1) that both parties understood that the LOI was not to be binding until a formal contract was executed; or (2) that the other party should have known that the party disclaiming the LOI did not intend to be bound). Proving subjective intent, sometimes many years after the fact, is difficult, and it is simply easier to warrant or represent the parties intent in the LOI at the time of

execution in a manner that creates a counter cause of action should the parties not stand behind their stated intent.

<sup>140</sup> See *infra* Section II.G. and Section IV.I. of Appendix A.

<sup>141</sup> See, e.g., *Arcadian Phosphates, Inc. v. Arcadian Corp.*, 884 F.2d 69, 73-74 (2d Cir. 1989).

<sup>142</sup> See John D. Calamari, *The Law of Contracts* 247-65 (4th ed. 1998) (discussing the history and modern applicability of promissory estoppel or detrimental reliance).

<sup>143</sup> For example, the doctrine of detrimental reliance generally requires that the reliance be reasonable and that the one making the promise reasonably believes that the promise will invoke action or forbearance, etc. An argument that claims any reliance on a document that on its face is non-binding is unreasonable seems very plausible, and that the person making a non-binding offer would probably not reasonably believe one would perform to their detriment based upon that offer.

<sup>144</sup> See *infra* Section II.H. and Section IV.I. of Appendix A.

<sup>145</sup> See *Space Imaging Europe, Ltd. v. Space Imaging L.P.*, 38 F. Supp. 2d 326, 330 (S.D.N.Y. 1999).

<sup>146</sup> Not specifically set forth by example in Appendix A.

<sup>147</sup> One or more of warranty of merchantability, title, fitness for a particular purpose, and/or non-infringement.

<sup>148</sup> See *infra* Section II.I. of Appendix A.

<sup>149</sup> See, e.g., *Ward v. PriCellular*, 1991 U.S. Dist. LEXIS 5000, \*3 (S.D.N.Y. 1991).

<sup>150</sup> See *Fru-Con Constr. Corp. v. KFX Inc.*, 153 F.3d 1150, 1152, 47 U.S.P.Q.2d (BNA) 1930 (Fed. Cir. 1998).

<sup>151</sup> *Id.* at 1152-53, 47 U.S.P.Q.2d (BNA) at 1931-32.

<sup>152</sup> *Id.* at 1154, 47 U.S.P.Q.2d (BNA) at 1933.

<sup>153</sup> *Id.* at 1155, 47 U.S.P.Q.2d (BNA) at 1934-35.

<sup>154</sup> *Id.* at 1154, 47 U.S.P.Q.2d (BNA) at 1933.

<sup>155</sup> *Id.*, 47 U.S.P.Q.2d (BNA) at 1933.

<sup>156</sup> *Id.* at 1155, 47 U.S.P.Q.2d (BNA) at 1934-35.

<sup>157</sup> *Id.* at 1157, 47 U.S.P.Q.2d (BNA) at 1937-38.

<sup>158</sup> See *infra* Section II.J. of Appendix A.

<sup>159</sup> See *Phoenix Mut. Life Ins. Co. v. Shady Grove Plaza Ltd. P'ship*, 734 F. Supp 1181, 1188 (D. Md. 1990) (noting that the LOI should be construed against the one drafting it).

<sup>160</sup> *Fru-Con Constr. Corp. v. KFX Inc.*, 153 F.3d 1150, 1157-58, 47 U.S.P.Q.2d, (BNA) 1930, 1936 (Fed. Cir. 1998). See also *Lexington Inv. Co. v. Southwest Stainless, Inc.*, 697 F. Supp. 139, 142-43 (S.D.N.Y. 1988).

<sup>161</sup> See *Midtown Realty, Inc. v. Hussain*, 712 So.2d 1249, 1252 (Fla. Dist. Ct. App. 1998) (finding plaintiff's arguments to be unpersuasive since they contradict the very language set forth in his LOI).

<sup>162</sup> Not expressly illustrated in Appendix A.

<sup>163</sup> Not expressly illustrated in Appendix A.

<sup>164</sup> See, e.g., *Winston v. Mediafare Entm't Corp.* , 777 F.2d 78, 82 (2d. Cir. 1985) (noting that the LOI may be argued to be binding if there is literally nothing left for the parties to negotiate). While the court was, in the end, not persuaded by this argument it still lead to timely and expensive litigation.

<sup>165</sup> See *Teachers Ins. & Annuity Ass'n of Am. v. Tribune Co.* , 670 F. Supp. 491, 498 (S.D.N.Y. 1987).

<sup>166</sup> See *infra* Section II.J. of Appendix A.

<sup>167</sup> An example of such a clause is: "The parties are independent contractors under this Agreement and no other relationship is intended, including a partnership, franchise, joint venture, agency, employer/employee, fiduciary, master/servant relationship, or other special relationship. Neither party shall act in a manner which expresses or implies a relationship other than that of independent contractor, nor bind the other party." See *infra* Section II.J. of Appendix A.

<sup>168</sup> See *Space Imaging Europe, Ltd. v. Space Imaging L.P.*, 38 F. Supp. 2d 326, 329 (S.D.N.Y. 1999).