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Real Estate Law

Is your non-binding letter of intent actually binding?

Early in commercial real estate transactions, parties will often seek to agree on the primary terms of the proposed deal to determine if they are "close enough" to justify the time and money required to pursue due diligence and negotiate definitive agreements. If the parties are close enough on the deal terms, they will often want to execute a non-binding letter of intent ("LOI") to memorialize the terms upon which they have reached an understanding to serve as a guide for their subsequent negotiation of definitive agreements. If parties wish LOIs to be non-binding, they should consider how New York courts interpret them.

Many New York court decisions have found LOIs to be binding that did not include language evidencing a clear intent that they be non-binding. Most decisions rest upon the specific language contained in (or omitted from) the LOIs, highlighting the need for careful drafting.

Leave it unsigned. If the parties intend a non-binding LOI, they should consider leaving it unsigned. The NY Statute of Frauds (NY GOL §5-703(2)) provides that a contract for the sale (or lease for more than one year) of real property is void unless in writing and signed by the party against whom enforcement is sought. Negotiating major deal terms is often difficult and time-consuming and many parties want to sign an LOI to acknowledge that they have reached a milestone in their preliminary negotiations. Also, parties who have successfully negotiated an LOI often overlook the possibility that the deal might not actually close. However, if the parties intend the LOI to be non-binding, they might be better served keeping it unsigned and proceeding directly to negotiating the definitive agreements.

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Include non-binding language. New York courts have consistently held that an LOI will be non-binding if it expressly provides that material terms to the proposed transaction remain unresolved and that the parties are not legally bound to each other unless and until more definitive agreements are executed. Without such express language, a court may find an LOI legally enforceable if its overall language evidences the parties' intention to be bound to each other and contains all material terms of the deal — even if the LOI contemplates the subsequent negotiation and execution of definitive agreements.

Avoid contract words. Since New York cases focus on the language of the LOI to determine the parties' intentions, when drafting non-binding LOIs it is best to avoid those words typically found in enforceable contracts, such as "offer," "accept," "agree," "commit," "shall" and the like. Instead, it is best to use less definitive words such as "presently intends," "expects" or "may."

Review transmittal letters. If a party sends an LOI (even unsigned) to another party that is intended to be non-binding along with a signed letter, carefully review the language in the letter to ensure that it doesn't contain language that undermines the intended non-binding nature of the LOI.

Enforceable provisions. Parties often wish to include binding provisions within an otherwise non-binding LOI. Examples include confidentiality and/or exclusive negotiation provisions. In such instances, consider whether those concepts would be better dealt with in a separate, more comprehensive agreement apart from the non-binding LOI. If that is not possible, then the LOI should clearly provide that while such specific provisions are binding, that the rest of the provisions of the LOI are not, that material terms remain unresolved, and that the parties will not be bound unless and until definitive agreements are executed.

Good faith negotiations. Non-binding LOIs often provide that the parties

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will pursue the negotiation of definitive agreements "in good faith." While such clauses may not be enforced by New York courts absent specific language specifying the criteria for "good faith," if an LOI is intended to be non-binding, it is best to omit such "good faith" language and instead state that either party can terminate negotiations at any time for any reason without liability whatsoever.

New York courts have consistently held that poorly drafted LOIs may be binding even if a party didn't intend that to be the case. It is the intention of the parties as evidenced by the language of the LOI that is dispositive. That being the case, purchasers and sellers of New York commercial real estate should spend the same time and effort in carefully drafting and negotiating LOIs as they would with the definitive transaction agreements. Otherwise, if the deal dies what may have been intended as a non-binding preliminary expression of intent might be held to constitute a binding contract.

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