MEYNER AND LANDIS LLP

COUNSELLORS AT LAW

03/11/15

The Often Used Letter of Intent – Is there a Binding Agreement

A common practice among business clients prior to or during the negotiation of a commercial transaction is to enter into a "letter of intent." The letter's function is exactly how it sounds – it serves to express a mutual interest of negotiating together towards a final agreement in good faith. The document is executed by the parties in order to provide a foundation of agreed-upon terms for ongoing negotiations. In a general sense, letters of intent can be advisable as they offer the ability of the parties to agree to important issues involved in the due diligence/negotiation process. For example, the parties may devise how expenses will be handled when inspections, audits, environmental costs, or other contingencies are involved. The letter of intent in a real estate transaction can also provide a buyer with peace of mind through the inclusion of an exclusivity provision prohibiting the seller from negotiating with other parties for some specified period of time. These agreements can be drafted in a manner to be as specific (or ambiguous) as the parties desire.

However, despite the many benefits a letter of intent can offer, the parties must carefully consider the value of a letter of intent that is not meant to function as the parties' "final" agreement. Although a party has an obligation to act in "good-faith" during the negotiation process, this obligation does not require the other party to ultimately consummate the

transaction. In fact, New Jersey Courts have taken a seemingly "hands-off" approach to good-faith violations in the negotiation process between business entities refusing to find a breach of the duty to act in "good-faith" even in instances where it seems fairly obvious that the letter of intent was meant to be the "final agreement" of the parties.

In W. Palm Beach Hotel, L.L.C. v. Atlanta Underground, L.L.C., No. CIV. 14-1063, 2014 WL 4662318, at *5 (D.N.J. Sept. 18, 2014), the District Court considered whether Plaintiff's increase in the sale price of commercial property by $500,000 after over a year of negotiations and the existence of a letter of intent constituted bad faith. The court quoted favorably from the Seventh Circuit stating that

> "Good faith" is no guide. In a business transaction both sides presumably try to get the best of the deal. That is the essence of bargaining and the free market. And in the context of this case, no legal rule bounds the run of business interest. So one cannot characterize self-interest as bad faith. No particular demand in negotiations could be termed dishonest, even if it seemed outrageous to the other party. The proper recourse is to walk away from the bargaining table, not to sue for "bad faith" in negotiations.

The District Court thus held that the requested price increase was not "bad faith." This approach follows similar New Jersey State Court precedent, refusing to find bad faith in the negotiations of business entities even where a letter of intent is involved. See Sun Pharm. Indus., Inc. v. Core Tech Solutions, Inc., A–0646–11 T4, 2013 WL 1942619 (N.J. Super. Ct. App. Div. May 13, 2013) ("These 'experienced commercial parties,' who only agreed to negotiate an agreement if mutually beneficial, can be safely left to 'fend for themselves.'").

With these cases in mind, parties should remain cautious before expending significant cost and expense during the "Letter of Intent Stage" as even an act of seemingly obvious "bad-faith" may not serve to bind the party who walked away from the deal.

Rosaria A. Suriano, Esq.
One Gateway Center, Suite, 2500
Newark New Jersey 07102
(973) 602-3460
RSuriano@Meyner.com

Matthew P. Dolan, Esq.
One Gateway Center, Suite, 2500
Newark New Jersey 07102
(973) 602-3478
MDolan@Meyner.com