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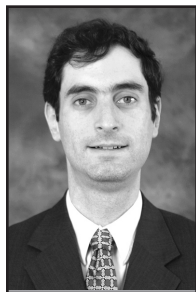
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Letter of intent lays groundwork

In many commercial real estate and business transactions, it is not unusual for the parties to enter into a letter of intent, sometimes called a memorandum of understanding or term sheet, before preparing, negotiating, and executing a formal agreement. A letter of intent is a short document summarizing the key provisions of a proposed transaction, and the parties usually sign it. Though parties generally do not want letters of intent to bind them, letters of intent can provide the framework for later establishing the formal agreement.

There are many benefits of letters of intent. A letter of intent can allow the potential contracting parties to outline the most important terms of a possible agreement to see if there is this minimum fit at the start of the process. A letter of intent also can help a party determine that the other party is serious about undertaking the transaction before committing additional time and expense. A letter of intent provides a written expression of interest that one party may be able to show to others outside the transaction, such as lenders, to demonstrate that interest in the project exists. For example, a lender may be more willing to loan money to the owner wishing to construct a building if the borrower can show that there may be tenants interested in leasing the building when completed by way of letters of intent.

It is possible that in the process of negotiating the final



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contract, the parties may decide not to proceed because they cannot reach agreement on some provision that the parties may or may not have envisioned at the time the parties entered into the letter of intent. A letter of intent, however, will help move the parties closer to an ultimate agreement in spite of these items left to be decided.

One area where letters of intent commonly are used is commercial lease negotiations. A landlord and tenant may enter into a letter of intent to determine certain basic elements of what the final lease will need to address. These could include items such as the rental rate, the term of the lease, whether the tenant is to have any renewal rights and if there are any inducements for the tenant, such as a tenant improvement allowance. After the landlord and tenant sign the letter of intent, the parties will prepare and negotiate a formal lease that addresses not only the items in the letter of intent, but also many other provisions.

A well-drafted letter of intent will specify that it is not to be binding on the parties if that is the parties' desire. Even with this language, how-

ever, there are a few instances where a letter of intent can bind the parties. If the letter of intent does not state that it is nonbinding and it contains the minimum terms needed for a contract, a court could view it as the binding document (even if there are other terms to work out). Also a party's conduct could cause a nonbinding letter of intent to become a binding agreement. If one party relies to its detriment on the conduct of the other party, the relying party may be able to convince a court that it would be unfair to not bind the other party. For example, if one party manifests an intention to be bound to the terms in the letter of intent and the other party reasonably changes its position in reliance, such as expending significant funds, the first party may become bound. Therefore, it is important that the parties to a transaction carefully review and prepare the letter of intent and monitor their conduct.

Even if the overall letter of intent is not binding, it could impose an obligation on a party to negotiate in good faith toward entering into the final agreement. If a party does not want this obligation, the party should insert a disclaimer of the obligation in the letter of intent.

Sometimes the parties may want a few provisions in a letter of intent that bind the parties, even if the letter of intent is not to be binding on the parties. For example, the parties may want the contem-

plated transaction to remain confidential. Even if the parties do not enter into a final agreement on the transaction, the disclosure of the contemplated transaction could have detrimental effects on one or both of the parties. Similarly, one party may make its private documents available for review by the other side. Therefore, the letter of intent may state that even if most of it is not binding on the parties, the parties will treat it and the contemplated transaction confidentially.

Some parties avoid letters of intent. Reasons for this reluctance include that it creates a two-step negotiation process: once for the letter of intent and once for the final document. Also, as stated above, letters of intent generally do not bind the parties, so it may seem like a wasted endeavor to negotiate something that does not bind the other side of a deal. Additionally, a party may not want the risk that this "nonbinding" document could somehow bind the party.

Despite these concerns, many parties to a transaction, along with their brokers and attorneys, may find that the use of a letter of intent can assist in the deal-making process if the parties know and address these risks. Using a letter of intent can allow the parties to address certain key terms, such as a price, to determine if it is worth the effort to enter into a more formal agreement on a transaction.▲