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Court Refuses to Find Letter of Intent Contains Duty to Negotiate in Good Faith

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Letters of intent are commonly used in the commercial landlord-tenant context. In the simplest sense, a letter of intent is a desire for the parties to enter into a contract without actually doing so. The letter of intent sets forth the principal terms and conditions of an "understanding," so to speak, between the parties and the basis for a contract. Only afterwards do the parties then begin the next phase of lease negotiations — preparation and execution of the lease. This way, the parties do not waste their valuable time and financial resources in drafting a lease until they know full well that they have a solid foundation for a meeting of the minds.

In order to encourage this streamlined process, however, most letters of intent contain language disclaiming its enforceability and expressly require lease execution so as to bind the parties to contract.

LEASE NEGOTIATIONS

The U.S. District Court for the Eastern District of Pennsylvania in *WP 851 Associates, L.P. v. Wachovia Bank, N.A.* recently refused to find that a letter of intent contained an implied duty for a prospective tenant to negotiate a lease in good faith with a property owner.

In early 2007, WP 851 was developing a parcel of land into a shopping center on the Main Line near Philadelphia. Wachovia Bank sought to lease a portion of that shopping center as a branch office. When WP 851 and Wachovia Bank discovered that the configuration of the shopping center could not accommodate the anticipated bank building, WP 851 agreed, in principle, to lease additional land from an adjoining property owner for Wachovia Bank's benefit.

Afterward, Wachovia Bank sent WP 851 a draft letter of intent outlining the proposed lease terms. The letter of intent contained numerous disclaimers. Among other things, the letter of intent stated that "[n]o such obligation [would] arise from th[e] letter and any resulting lease drafts unless and until a

mutually satisfactory lease [wa]s fully executed by, and delivered to, all parties" and that the terms and conditions of the letter were still subject to the review and approval of Wachovia Bank's real estate committee.

WP 851 subsequently confirmed in writing that the parties had reached an agreement for Wachovia Bank to become a tenant of the shopping center. Wachovia Bank thereafter volunteered to perform the first draft of the lease.

Not only did several rounds of revisions of the lease take place but also, with Wachovia Bank's assistance, WP 851 began the process of obtaining land development approval from the local governmental authority for the bank building.

Wachovia Bank eventually ceased lease negotiations with WP 851. WP 851 then found out that Wachovia Bank was finalizing the terms of a lease agreement with another property owner and intended to develop a branch office on a different property instead.

WP 851 filed a complaint against Wachovia Bank asserting, among other things, a claim for breach of the duty to negotiate in good faith. Wachovia Bank moved for dismissal of that claim.

TRIAL COURT DECISION

The federal district court refused to find that the letter of intent in *WP 851* created an implicit agreement for Wachovia Bank to negotiate with WP 851 in good faith.

While noting that the Pennsylvania Supreme Court had not yet addressed whether a letter of intent can create such a duty, the federal district court pointed to the 3rd U.S. Circuit Court of Appeals' ruling in *Channel Home Centers v. Grossman*, where the appellate court predicted that the Pennsylvania Supreme Court would find that an agreement to negotiate in good faith would be enforceable if it meets the requisite elements of a contract.

Similar to *WP 851*, *Channel Home Centers* involved an agreement between a commercial property owner and a prospective tenant. Applying Pennsylvania law, the appellate court in *Channel Home Centers* focused its inquiry on whether the parties manifested an intention to be bound by the agreement, whether the terms of the agreement were sufficiently definite to be enforced and whether there was consideration.

In *Channel Home Centers*, the appellate court found such a duty existed because, under the letter of intent, the property owner "'unequivocally promised' to withdraw a piece of property from the market and to negotiate a lease only with the [tenant] 'to completion.'" The appellate court "found other indicia of an intent to be bound persuasive, including the level of detail in the letter and the subsequent actions of both parties."

The federal district court in *WP 851* then compared the 3rd Circuit's holding in *U.S.A. Machinery Corp. v. CSC Ltd.* to that in *Channel Home Centers*. In *U.S.A. Machinery Corp.*, the appellate court found that "an oral 'registration' between a broker of steel-making equipment and a purchaser and seller of

equipment did not give rise to an agreement to negotiate in good faith because the parties did not expressly agree to negotiate in good faith and had not made extensive preparations to further or consummate the transaction."

In distinguishing *Channel Home Centers*, the appellate court in *U.S.A. Machinery Corp.* noted that the parties lacked a "'similar indicia of intent to be bound' ... because there was 'no detailed expression of the parties' intent.'"

The federal district court in *WP 851* thus surmised that, under 3rd Circuit precedent, which has predicted how the Pennsylvania Supreme Court would react under the circumstances, "in order for an agreement to negotiate in good faith to be enforceable, the parties must manifest a specific intent to negotiate in good faith."

In a footnote, the federal district court also mentioned two occasions where the Pennsylvania Superior Court has refused to find that a letter of intent embodied an agreement to negotiate in good faith. According to the federal district court, in *GMH Associates Inc. v. Prudential Realty Group* and *Philmar Mid-Atlantic Inc. v. York Street Assoc. II*, the Superior Court, respectively, found that such a duty did not exist because the letter of intent did not include an express term regarding such a duty or a mutual assent to be bound.

Similar to the Superior Court's ruling in *GMH Associates Inc.*, the federal district court in *WP 851* pointed out that the Eastern District in *Milandco Ltd. v. Wash. Capital Corp.* refused to find the existence of a duty to negotiate in good faith because the letter of intent did not contain an "expression that the parties agreed to negotiate a deal in good faith."

After reviewing the language contained within the letter of intent in *WP 851*, the federal district court concluded that such an implied obligation to negotiate in good faith did not exist. The federal district court first pointed out that the letter of intent explicitly stated that it was not enforceable.

In another damaging blow to *WP 851*, the federal district court noted that the letter of intent only included an obligation for *WP 851*, not Wachovia Bank, to negotiate in good faith. Noticeably absent from the letter of intent was a provision requiring Wachovia Bank "either to negotiate in good faith or to refrain from engaging in negotiations with other prospective landlords."

Finally and most importantly, the federal district court refused to find that a duty to negotiate in good faith might be implied by surrounding circumstances. Rather, the federal district court stated that the parties must expressly agree to negotiate a deal in good faith. In doing so, the federal district court merely confirmed previous rulings rendered by federal and state appellate courts in Pennsylvania.

LESSONS LEARNED

The federal district court's ruling in *WP 851* illustrates the potentially devastating consequences of letters of intent and why attorneys representing landlords and tenants in this forum should tread carefully.

In essence, a landlord or tenant who is inexperienced with the usage of a letter of intent may detrimentally rely on its existence. Before doing so, such a landlord or tenant must, at the very least, include language in the letter of intent requiring his counterpart to negotiate in good faith. On the flip side, of course, a landlord or tenant who wants to keep his leasing options open should not execute a letter of intent expressing such an agreement to negotiate.

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