

Letters of Intent: What Are They?

The February 2002 "Legal Stream" discussed the importance of drafting contracts that contain all of the terms and conditions intended by the parties. Otherwise, an incomplete contract simply may be an invitation to litigation.

Along the same lines are issues that arise from so-called letters of intent commonly used by public utility systems and other parties in a contract negotiation process. The problem again is that some people may think that their "letters of intent" or "letters of understanding" are not contracts; others may think that they, in fact, are letter agreements; and courts may fool everyone by holding one way or the other. However, the end result arises from the manner in which these letters are drafted. Simply stated, the language used or not used will give rise to the consequences, even if not intended by one or both of the parties.

In *Stand Energy Corp. v. Cinergy Services Inc.*, 760 N.E. 2d 453 (Ohio App. 1 Dist. 2001), an electricity broker sued a buyer for a declaratory judgment that a contractual *force majeure* clause and event excused a failure to deliver power. The buyer asserted a counterclaim.

One of the issues in the case was whether a certain letter of intent was an enforceable contract. According to the court, the broker and buyer signed a document called "a letter of intent on-peak power supply" to the buyer. The letter stated that the broker "shall sell power" and "shall deliver" to the buyer 200 MW for three years beginning in 2000. It also contained the purchase price, *force majeure* clause, confidentiality requirements and assignment provision.

According to the court, the letter "contained four contingencies, or conditions precedent, to be satisfied prior to execution of a formal agreement including execution of the letter of intent, negotiation, execution and delivery of a mutually acceptable agreement for power supply, acquisition of regulatory approval and an arrangement for transmission of the power." *Id.* at 456.

In the litigation, the buyer asserted that the letter of intent was an enforceable contract. It argued that the detailed description of the terms of the proposed agreement, particularly the language that the broker shall sell and deliver the power, showed that the parties intended to be bound by the letter of intent. The court disagreed.

The court stated that a letter of intent is not *per se* unenforceable. Rather, enforceability depends on whether the parties have demonstrated an intention to be bound by its terms, and whether these intentions are sufficiently definite to be specifically enforced. *Id.* at 459.

The court noted that, despite reference to the broker's obligation to sell and deliver power, the letter referred to a proposed agreement, a proposed date of execution, noted that some terms were to be determined in a more definitive agreement, and was contingent on certain conditions precedent. "At most, the letter of intent was evidence of the parties' intent to enter into a business relationship involving a two-hundred MW contract sometime in the future, after the purpose and terms of the agreement were memorialized in another writing." *Id.* at 460. The court also noted that the four contingencies stated in the letter had not been satisfied.

On the other hand, where a letter of intent does not clearly indicate that there is no contract until a written agreement is developed and mutually signed, a court may find that the letter is a contract. "Where a letter says that it is subject to the terms of a contemplated mutual agreement to be written and signed in

the future, but other evidence indicates that the parties decided to be bound by the terms of the letter, the letter may amount to a contract." *Rennick v. OPTION. Care, Inc.*, 77 F.3d 309, 316 (9th Cir. 1996). See also *Williston on Contracts*, § 4.8 (4th Ed.).

Actually, a letter of intent can be a hybrid: not a contract, yet a contract. For example, a letter may state that it only expresses the intent of the parties to negotiate a written agreement in the future containing certain terms. Further, it may state that there is no contract until a definitive written agreement is executed. At the same time, the letter may include an agreement providing for a deadline for execution of a contract, confidentiality of information exchanged in negotiations, or a prohibition against dealing with other potential parties.

In *Vermont Teddy Bear Co., Inc. v. Tyco Industries, Inc.*, 80 F.Supp. 2d 36 (N.D.N.Y. 2000), the court rejected an attempt by one of the parties to rely on a letter of intent to modify or supplement the terms of a written agreement. The court seemed to say that the letter could be used to "clarify" the agreement but not to modify it.

These cases again illustrate the importance of good drafting. If a letter of intent is not to be deemed a contract, it must contain clear language that the parties do not intend the letter to be a contract. The focus should be on how a court likely would interpret the letter based on the language of the letter. On the other hand, if the parties mean it to be a letter agreement, then such intent and the relevant terms should be demonstrated unequivocally in the letter. The point is that the parties have the opportunity and responsibility of clearly evidencing their intent through their drafting. 

