



Best Practices When Using Term Sheets, Letters of Intent Or Memoranda Of Understanding In Commercial Finance Transactions

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In light of the recent decision by the United States Court of Appeals for the Second Circuit, *Lehman Bros. Holdings Inc., Shinhan Bank v. Lehman Bros. Holdings, Inc.*, 2018 U.S. App. LEXIS 19783 (2d Cir. July 18, 2018), in which the Court bound parties to a transaction through a mere exchange of emails, we thought it would be useful to provide a refresher on the risks of using term sheets, letters of intent

("LOI") and memoranda of understanding ("MOUs"). These documents are prevalent in commercial finance transactions. The chief benefit of using them is that they set forth the basic framework of the contemplated transaction. Immediately, the parties will know whether they desire and intend to accept the same material terms, before proceeding with the gritty (and often costly) negotiations of any final agreement. However, given that these writings may result in fully binding obligations even when parties anticipate executing a subsequent, final and detailed agreement, parties must be mindful of the potential consequences of using them.

Whether To Use Them

As an initial matter, a party should first consider what it seeks to achieve by using a term sheet, LOI or MOU. On the one hand, a party may seek to bind its counterparty to legally enforceable obligations while the parties negotiate their anticipated ultimate and final agreement. Conversely, a party may wish to be able to walk away from the negotiations at any time, for any reason and without any legal consequence. Finally, a party may seek to commit its counterparty to negotiate open terms in good faith, to

avoid expending time and money needlessly if that party seeks to arbitrarily abandon the negotiations. If a party decides to use a term sheet, LOI or MOU, the next step is drafting it appropriately to achieve its goals.

Depending on the nature of the finance transaction at issue, one of these pre-contractual writings may be better suited than the others to achieve the party's goals. A term sheet lists proposed deal terms in a bullet point or similar format; an LOI is typically written in letter form and an MOU is generally in the form of a memorandum. Using a term sheet has certain benefits. Experienced parties and their counsel will immediately grasp the import of the key terms and use the document as a guide for negotiations. In short, it saves time. Moreover, due to its abbreviated nature, it is less likely to result in unexpected and unintended binding obligations.

General Rules of Construction

A court will look to the language of term sheet, LOI or MOU first to determine its import and effect. The document's language is considered as the best objective indicator of party intent, and is often dispositive. While a court may view partial performance as indicating a binding agreement, it may nonetheless discount even substantial partial performance, accepted by the other party, in light of other facts. A court will generally employ a flexible analysis (considering, for example, the subject matter, complexity and type of transaction at issue, the nature of any remaining open terms, and custom and practice as to these matters) to determine whether the parties agreed to the necessary aspects of their agreement, and if and how they intended to be bound, if at all. Lastly, a court may consider the context of the negotiations themselves when construing the meaning of one of these documents.

Drafting Considerations

Drafting term sheets, LOIs and MOUs must be done with care, deliberation, and forethought. Depending on the documents' language and terms, a court may hold that, although preliminary, and even if the parties intended to execute a subsequent, more comprehensive and final agreement, the parties nonetheless reached a binding, enforceable contract. In such a case, one party may sue the other for damages or specific performance for breach. A court may also determine that the parties bound each other to negotiate open and unresolved terms in good faith. In this case, a court may require a party to continue negotiations, even though it may desire to cease negotiating for any number of very legitimate reasons. Courts may impose injunctive relief or award reliance damages if a party abandoned negotiations arbitrarily, however. Finally, as noted, a court may construe a term sheet, LOI or MOU as a completely unenforceable negotiating device which places no obligations on any party. Again, depending on what a party seeks to achieve by a term sheet, LOI or MOU, the writing should be drafted accordingly.

Drafting Practice Pointers

The following are some helpful drafting points to remember:

- Parties must state, in clear and plain language, the promissory obligations, if any, that the parties desire to be binding and enforceable.
- If parties desire to remain free of binding obligations, entitle the document accordingly (i.e., "non-binding and unenforceable, for discussion purposes only" and include a provision stating that it is completely non-binding and unenforceable.
- If parties desire certain terms to be binding (for example, non-disclosure and confidentiality clauses), set forth those obligations and state that the parties agree that only those obligations, and no others, are binding and enforceable.
- If parties desire certain pre-conditions to be satisfied before any binding obligation arises (for example, if financing is to be obtained), set forth the pre-condition and state that it must occur for any binding obligation to arise. Add that, if the pre-condition is not satisfied, no binding obligation exists or arises.
- If parties seek to condition their proposal upon the approval of third-party (such as a board, investment committee, financing institution), entitle the document accordingly (i.e., "subject to approval") and include clear terms stating what approval is required and all of the specifics for the approval to become effective.
- If the transaction is subject to completion of due diligence, entitle the document accordingly (i.e., "subject to the completion of due diligence") and include provisions setting forth how the completion of due diligence is to be effected, as well as what results if a party is dissatisfied after due diligence (i.e., negotiations may be terminated in the sole discretion of the dissatisfied party, or conversely, an objective benchmark must be triggered, such as a material inconsistency with previously provided information).

Proposed Disclaimers

Some suggested disclaimers to make clear the writing is non-binding are:

- The document is non-binding in every respect and is merely for discussion purposes.
- The parties agree that their negotiations may not result in any enforceable contract whatsoever.
- The parties are not bound in any respect unless and until a final, written agreement is signed by all parties.
- There is no oral or written agreement concerning the subject matter of the negotiations set forth in the term sheet, LOI or MOU.
- The parties bear their own costs for the negotiations and waive claims as against the other for any reliance damages; even if any party changes its financial position as a result of the document or otherwise relies on it or on the negotiations.

Proposed Binding Terms in an Otherwise Non-Binding Term Sheet, LOI or MOU

Parties may desire that the parties bind each other to certain legally enforceable obligations even when their term sheet, LOI or MOU is otherwise non-binding. Examples include: (i) provisions concerning confidentiality, return of confidential information, designated contacts for confidential information, and survival of confidentiality after negotiations; (ii) exclusivity provisions; (iii) non-circumvention provisions; (iv) standstill covenants; (v) a break-up fee or non-refundable deposit and (vi) a dispute resolution provision concerning the breach of any binding term.

Careful consideration should be given to the breadth of binding commitments, their usefulness and enforceability.

About Marc L. Hamroff and Stephen L. Brodsky

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