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Letters of Intent: What Do They Really Do? [Ober|Kaler]

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A construction project usually contains a web of contractual relationships, such as between owner-contractor, contractor-subcontractor, subcontractor-supplier, owner-architect, architect-engineer, and so forth. To make things even more complex, construction parties often use letters of intent. A letter of intent ("LOI") can serve several purposes. At one end of the spectrum, it may create a binding contract. At the other end, the LOI may represent merely an expression of good will between the parties, a kind of "agreement to agree." There are also stops in between.

The two parties to the LOI, however, may sign the document but have different expectations of what the LOI represents. If the deal later falls apart, one of the parties may look to the LOI to keep the other party bound by the perceived agreement, much to the surprise and chagrin of the second party. Litigation may be the end result. A recent Maryland Court of Appeals decision frames the issue well. It teaches a good lesson for people in construction about how to structure a deal versus a non-deal.

In *Falls Garden Condominium Assn., Inc. v. Falls Homeowners Assn., Inc.*, 441 Md. 290 (2015), the Maryland Court of Appeals held that the LOI created a binding contract for a 99 year lease involving a parking lot. An association of homeowners fought with an association of condominium unit owners over ownership and control of a parking lot located between their two developments. The homeowners posted towing signs and painted curb markers stating that the parking spaces were for their exclusive use. Eventually the condominium unit owners sued the homeowners. To settle the lawsuit, the parties executed an LOI which stated, in part, that the parties planned to memorialize their settlement in a separate lease agreement with certain terms, which would provide for a lease of 24 parking spaces, with a rate of $20 per space per month, for a term of 99 years; and that the lease "shall contain the usual and customary provisions regarding dates and methods of payment, provisions for default and breach, severability, signs, quiet enjoyment, waiver and the like." A draft lease was sent to the homeowners, but they decided not to move forward. The condo owners then moved to enforce the LOI.

The trial court ruled that the terms of the LOI itself were definite and complete enough to create a binding contract. The trial court denied a request for a hearing where the homeowners planned to testify that they did not intend to be bound by the LOI but only when the lease was signed. The appellate court agreed with the trial court and affirmed the decision.

In reaching its decision, the Court of Appeals noted that letters of intent fall into four distinct categories:

1. One or both parties state specifically that they intend not to be bound until the formal writing is executed;
2. The parties point to specific matters that must be agreed upon before negotiations are concluded;
3. The LOI includes an agreement on all necessary terms but is silent as to other, non-essential terms that are often included in similar contracts; and
4. The LOI contains all material terms and states that it is intended to be a binding agreement.

The Court of Appeals noted that "[a] valid contract generally has been made if a letter of intent properly falls within the third or fourth category." (citations omitted). To the court, there are two key issues: (1) the intent to be bound and (2) the definitiveness of the terms. The intent to be bound analysis looks at several factors, including whether terms were left open, whether performance began, whether the agreement has few or many details, whether the amount involved is large or small and whether it is a common or usual contract.

In Maryland, as in most states, an "objective" test for interpretation of contracts is used. That means that what is important is what a reasonably prudent person in the same position would have understood. The issue does not depend upon the unexpressed subjective intention of one of the parties. Therefore, it is irrelevant if one of the parties believed the LOI was not binding.

In the *Falls* case, the LOI contained sufficient terms that were definite. The fact that other terms, not material for the deal, were left open did not prevent the LOI from being binding. In effect, the court found that the LOI fit into the third category.

The lesson for construction parties is simple: say what you mean and mean what you say. If, for example, the LOI is not intended to be binding unless and until a more formal contract is signed (the first category), the LOI should expressly state that. If, on the other hand, the LOI is intended to be binding until it is replaced by another written contract (the fourth category), it should state that instead. It is difficult at times to distinguish between the second and third categories. To avoid later disputes, I recommend that the parties clearly make their document fit within either the first or the fourth category.

Either way, careful drafting can make clear the parties' intentions. Litigation may result when the subjective intentions of the parties are not clearly expressed or conflict with the written words. The parties should not put their fates in the hands of a game show host who asks "Deal or no deal?", where the contestants have no idea what awaits inside the case.