Bound to Negotiate?

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When landlords, tenants, buyers or sellers begin to negotiate any real estate lease, loan or contract, they often first try to work out a term sheet or a letter of intent. This way, they can assure that "everyone's on the same page" before they move on to more full-blown––and more expensive––negotiation of actual deal documents. Can a term sheet or a letter of intent create legal liability? Most real estate people and their lawyers assume not. They assume that these documents are just a way to write down concepts to help the parties focus and decide whether they should try to proceed to a "deal."

A recent California Court of Appeals case, *Copeland* v. *Baskin Robbins,*(1) suggests that the commonly held view of these documents may be wrong, or at least over-simplistic. In *Copeland*, the court decided that when a seller entered into a letter of intent, the seller became legally bound at least to negotiate with the buyer. The seller could not arbitrarily cut off discussions. When the seller did change its mind about the whole deal, the court held that the seller had breached its promise to negotiate, and the buyer could recover damages.

Traditionally, term sheets and letters of intent were regarded as unenforceable "agreements to agree." One reason is that a court is ill-equipped to determine what type of performance an "agreement to agree" would require. Would the parties be forced to agree on certain terms? What if this were impossible? What if a party chose not to agree to any price or terms that the other party offered? Also, traditional contract law requires that all essential terms of a contract be set before a contract is formed. If parties promise to agree in the future, there is, as a general rule, no legal obligation until the final terms are agreed upon. So what happened in *Copeland*?

The negotiations began when Copeland wanted to buy an ice cream plant that Baskin Robbins wanted to close. As in any typical real estate negotiation, Baskin Robbins sent a letter of intent to Copeland. The letter contained details its executives had approved for the potential deal, but also included a statement that Baskin Robbins would enter into a "co-packing agreement" for the factory "subject to a separate co-packing agreement and negotiated pricing."(2) Baskin Robbins asked Copeland to sign and return a copy of the letter and send a check if the terms were acceptable. Baskin Robbins also said it should be able to coordinate a closing within 30 days. After signing the letter, Copeland and Baskin Robbins started to negotiate a co-packing agreement, including issues of price, flavors, quality standards, risk allocations and trademark protection. After 60 days of negotiations, Baskin Robbins cut off discussions and returned Copeland's deposit for reasons it said were "strategic."(3) Copeland sued, claiming Baskin Robbins had breached an agreement to negotiate a co-packing agreement.

California's Second District Court of Appeals decided that, under these facts, Copeland could recover damages for breach of a contract to negotiate an agreement.(4) The court started by acknowledging that an "agreement to agree" is not enough to constitute an enforceable contract. The court said, though, that "these difficulties could be overcome in an appropriate case."(5) It distinguished between a contract to *negotiate* in good faith and an agreement actually to *agree* to an ultimate deal. The court decided that an agreement to negotiate can be a contract in its own right, even if the ultimate deal is not yet enforceable.(6)

What, then, is an enforceable agreement to negotiate? When does an unenforceable "agreement to agree" become an enforceable "agreement to negotiate"? In *Copeland*, the court avoided this question, instead simply finding a contract, based

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apparently on the court's stated desire to "protect[] parties to a business negotiation from bad faith practices by their negotiating partners."(7) The court concluded that the business world needed this protection because negotiations are more complex today (as opposed to "the days when our ancestors sat around a fire and bargained for the exchange of stone axes for bear hides").(8) Negotiations take longer because more information takes longer to flow between the parties.(9)

In the court's opinion, this costly process requires assurance that one party is not wasting the other's time by dragging its feet or changing its mind.(10) The fact is, however, that one of the usual purposes of any negotiation is to let each party preserve its ability to drag its feet, change its mind, sort through the issues and take the time to decide on terms that, considered as a whole, meet that party's needs. Until all of that has happened, does either party really expect to incur liability if it changes its mind and decides not to go forward? Until final documents have been signed, doesn't any party to a business negotiation assume the risk of wasting time on futile discussions?

The court seemed sympathetic that Copeland had spent time and money with nothing to show for it. The court even used an ice cream simile to describe Copeland's "dilemma": "'Many millions of dollars' in anticipated profits had melted away like so much banana ripple ice cream on a hot summer day."(11) Though the court said Baskin Robbins had breached an agreement to negotiate, the court seemed influenced by the negative result for Copeland––the fact that they never achieved agreement or the profits that might have followed. Because the Copeland court did not explain exactly what an enforceable agreement to negotiate is (as opposed to an unenforceable "agreement to agree"), anyone who wants to practice "safe negotiation" must look to other cases that have resolved similar disputes.

The Copeland court described one such case, *Channel Home Centers* v. *Grossman,(*12) as "illustrative."(13) In *Channel Home Centers,* a shopping center lease dispute decided under Pennsylvania law, the court found a letter of intent enforceable––as a binding agreement to negotiate––because it met the requirements of a contract under Pennsylvania law(14):

1. The parties manifested an intent to be bound by its terms;
2. The terms were sufficiently definite to be specifically enforced; and
3. Valuable consideration was exchanged by both sides.(15)

In the *Channel Home Centers* case, the letter agreement spelled out fundamental business terms of the lease. It went on to say: "an Agreement of Lease, prepared by Tenant, but in a mutually satisfactory form, is to be executed by the owner of the Shopping Center." The letter agreement said the deal was subject to approval by Channel Home Centers' parent company and its retail group, and to Channel Home Centers' approval of the landlord's title. Finally, it stated (among other things): "Any expenditure by the Landlord or Tenant prior to execution of the Agreement of Lease shall be at the party's own risk."(16) Even with these "outs" in the letter, the court found that the parties intended to be bound to negotiate because the letter of intent was signed by both parties, and both parties took subsequent steps such as preparing a draft lease, planning for representatives to visit the lease property, developing marketing plans and applying for a zoning permit.(17)

The court also looked for, and found, definite, specific promises that could be enforced––in this case, the landlord's agreement to withdraw the store from the rental market and only negotiate this particular transaction to completion.(18) (The promise to take the store off the market, alone, did seem specific and fully thought through. If the case merely enforced that promise for some reasonable period of time, it would seem unobjectionable. But the case went further, and found an enforceable agreement to negotiate.) Finally, the court looked for, and found, valuable consideration passing between the parties. The landlord agreed to withdraw the property from the rental market, which assured that the property would stay available for the potential tenant, and the potential tenant signed the letter of intent, which the landlord could use to obtain a loan.(19)

Each circumstance the *Channel Home Centers* court relied upon is a common element early in the negotiation process of almost any major commercial lease. If asked, few businesspeople would expect to be legally bound at that stage (other than, perhaps, to keep the property off the market for some decent interval). More likely, they would regard the letter of intent––even a detailed letter of intent––as a prelude to a deal but not legally binding. If *Copeland* and *Channel Home Centers* imply that a party can be legally obligated to negotiate, what does that mean? How does it vary from an unenforceable agreement to agree? How would a party fulfill or perform an agreement to negotiate? Would a party have to go through the charade of quoting a very unattractive price in order to meet this obligation? Or would that be a breach as well? Would there be a duty to consider the other side's proposals, as courts have sometimes found in cases where parties with consent rights have incurred liability for refusing even to consider the other party's proposals?

How will a party prove that he or she has considered a proposal? And just how hard and how closely must each party consider the other side's proposals? Whenever the parties try to negotiate but cannot reach a final deal, the *Copeland* case now invites the courts to wade through the sad history and try to figure out who failed to live up to their agreement to negotiate. This is hardly what businesspeople expect when they sign a letter of intent.

The *Copeland* court said that we should all just rely on the common sense of jurors to figure out whether a party negotiated in good faith. This is a question of fact, the court said. A jury can decide, through "experience and common sense," whether parties have negotiated in good faith.(20) The court even tried to respond to the concern that ordinary jurors do not usually negotiate large corporate contracts: "While few of us will ever negotiate a multi-million dollar contract, each of us participates in some form of negotiation nearly every day."(21) The notion of having a jury assess whether a businessperson performed under an "agreement to negotiate"––and, if not, how much the defendant owes––will terrify most businesspeo-

ple. Perhaps letters of intent now need to contain not only the protective language suggested later in this article, but also a jury trial waiver.

In the real world outside the courtroom, part of the cost and risk of doing business consists of the possibility that some apparent "deals" will ultimately turn out not to be "deals," even if they looked promising early in the process. Disappointed dealmakers usually just move on to the next deal. If *Copeland* turns out to be good law, though, disappointed dealmakers may find the courts to be a more attractive next stop, with judges serving as all-purpose problem-solvers for every possible problem––a trend by no means limited to the vicissitudes of ice cream contract negotiations. In its apparent desire to "do the right thing" to solve Copeland's problem and protect Copeland from the risk and cost of "losing the deal," the *Copeland* court ultimately created more uncertainty, more issues and more paper. Decisions like this one simply force businesspeople and their lawyers to add new protective language to term sheets and letters of intent.

For example, every letter of intent or term sheet should now probably contain language like the following:

> "This letter of intent [term sheet] (the *"Preliminary Document"*) is for discussion only. Neither party is under any obligation, including any obligation to negotiate the proposed transaction. Each party may discontinue discussions at any time for any reason or no reason. The Deposit merely constitutes evidence of good faith and intention to pursue discussions. It does not constitute consideration for any obligation of any party. No party shall be bound in any way unless and until final documents have been agreed upon, executed, and exchanged. Each party shall bear its own expenses and proceed at its own risk."(22)

Beyond relying on a disclaimer, parties should avoid using any language that might be construed as a promise to negotiate or to reach an agreement. For example, the *Channel Home Centers* letter of intent said, "you will . . . only negotiate the above described leasing transaction to completion." The *Copeland* letter said, "[w]e should be able to coordinate a closing [within] thirty days thereafter." In each case, it would have been safer to say that the parties expected that they "may" reach an agreement. Finally, if a term sheet or letter of intent is truly not intended to be legally binding, why sign it? Why not just circulate it for review and consideration as one might an agenda for a meeting? This might help eliminate any uncertainty at all about the legally binding effect of the document.

As the only piece of good news in the Copeland case, the court limited Copeland's remedy to "reliance" damages––any losses that Copeland suffered as a result of "relying" on Baskin Robbins's promises.(23) These would include out-of-pocket costs of negotiations and maybe the cost of lost opportunities. They would not include the profits Copeland might have realized from the deal, partly because no court could determine what deal the parties "should have" made and how much it "would have" been worth.(24) The court ultimately decided that Copeland had suffered no reliance damages and, therefore, awarded nothing.(25)

Even though Baskin Robbins got the last laugh, it was an expensive last laugh. Anyone negotiating a letter of intent needs to pay attention to this case. It means that businesspeople and their lawyers need to stay alert for potential legal liability––and write their documentation accordingly––at the early "negotiating" stages, just as much as they do when they think they have reached the final stage of contract formation.

Once again, when the courts get creative, documents get longer.

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(1) 117 Cal. Rptr. 2d 875 (2002).
(2) *Id.* at 878.
(3) *Id.* at 877–78. Mere delay might have been a factor, too. The letter of intent projected a closing in 30 days. When the parties were still going back and forth 60 days later, might Baskin Robbins reasonably have concluded that the deal was not really going anywhere?
(4) *Id.* at 880.
(5) *Id.*
(6) *Id.*
(7) *Id.* at 884.
(8) *Id.*
(9) *Id.* at 884–85 ("[Deals] are the product of a gradual process in which agreements are reached piecemeal on a variety of issues in a series of face-to-face meetings, telephone calls, e-mails and letters involving corporate officers, lawyers, bankers, accountants, architects, engineers and others.")
(10) See *Id.* at 885.
(11) *Id.* at 879.
(12) 795 F.2d 291 (3d Cir. 1986).
(13) *Copeland* v. *Baskin Robbins*, 117 Cal. Rptr. 2d 875, 882 (2002).
(14) *Channel Home Centers,* 795 F.2d at 299. Not long after this case was decided, Channel Home Centers was in bankruptcy, unable to replicate in the marketplace the success it had achieved in court.
(15) *Id.* at 298–99.
(16) *Id.* at 293, fn. 2.
(17) *Id.* at 299–300.

(18) *Id.* at 300.
(19) *Id.*
(20) *Copeland,* 117 Cal. Rptr. 2d at 883–84.
(21) *Id.* The proposition that everyday consumer negotiations are not all that different from lengthy and complex business negotiations somewhat undercuts the court's belief that modern business negotiations are so fundamentally different from historical contract negotiations that they merit liability for breach of an "agreement to negotiate."
(22) One might want to go a step further and have a disclosure like this appear in all capital letters, and perhaps even have the parties initial it separately. California seems to love such measures. At the opposite end of the spectrum, if the parties do intend to be legally bound by only certain provisions in a term sheet or letter of intent, they can say so. For example, in one recent transaction the author's client "lost" one lease and, therefore, requested that the term sheet with the next landlord provide (as a binding obligation) that if either party terminated negotiations that party would reimburse the other's attorney fees. To no great surprise (in retrospect), the author's client was the party that ultimately decided to walk away from the second transaction.
(23) *Id.* at 885.
(24) *Id.*
(25) *Id.* at 886.