“SANTANA ROW ROW” LEADS TO $16M+ JUDGMENT!!

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We have written many times before about the importance of clearly specifying whether your “letters of intent” are binding (remember the mother of all letter of intent cases, the $11 billion judgment in Texaco vs. Pennzoil!). Now, there is a new case in California driving home the point once again. (See our sample non-binding letter of intent language at the end of this advisory.)

This new case, which the Appellate Court decided last month, resulted from a dispute over a one-page, nine-bullet point document signed in August, 2000. Federal Realty, the developer of Santana Row, the half-billion dollar mixed-use development in San Jose, entered into the one-page “Final Proposal” with the owners of First National Mortgage, who owned a 24,000 square-foot office building surrounded on three sides by Santana Row. Federal Realty wanted to demolish the office building and construct a parking garage and condominium tower on the property.

Federal Realty had pursued the ground lease or purchase of the office building site for many years as part of its development of Santana Row, and had exchanged several “Proposals” to buy the property with First National. Each of those proposals, until the Final Proposal in dispute, contained Federal Realty’s standard non-binding agreement clause.

When the “Final Proposal” was signed by both parties, instead of the non-binding clause, the following clause was inserted, which was the basis for this lawsuit:

The above terms are *hereby accepted by the parties* subject only to approval of the terms and conditions of a formal agreement.

The nine-point Final Proposal provided for a Ground Lease of the property by Federal Realty (including $100,000 per month rents and three percent annual rent increases, *but importantly did not provide the length of the term of the Ground Lease).* The Final Proposal also granted the Seller, First National, a “put” requiring Federal Realty to purchase the property at any time over

a period of *ten years.* Federal Realty was also granted a "call," whereby it could purchase the property at the end of ten years. Federal Realty also agreed to pay the relocation expenses of the building's tenant. Finally, Federal Realty was to prepare the formal legal agreement for First National's review. The effective date of the Final Proposal was to be the date that the existing tenant vacated the property.

After signing the Final Proposal on August 25, 2000, Federal Realty and First National began a series of negotiations that lasted for many months as they attempted to agree upon the terms of the formal agreement. The parties discussed a 34-year Ground Lease vs. a 50-year Ground Lease. They also discussed an outright sale of the property without any lease, but First National was unwilling to sell the property for less than $15M, which was not acceptable to Federal Realty.

During the time that these negotiations were continuing, First National gave the building's tenant a notice to vacate the building. When the tenant had moved, First National requested that Federal Realty pay the tenant's relocation expenses pursuant to the Final Proposal. Federal Realty responded that it had no obligation to pay the relocation expenses because there were many business points outstanding, and there was still "no binding agreement in place." Shortly thereafter, the dot.com bubble burst and no formal agreement was ever reached.

First National then filed a lawsuit against Federal Realty for the value of the rent over *ten years* plus the damages that First National suffered as a result of the loss of First National's call option in the Final Proposal. Federal Realty defended the case, stating that there was (1) never a binding agreement between the parties, and (2) even if the Final Proposal was an "agreement," there were not sufficient terms to make it enforceable (specifically, there was no term for the Ground Lease, which was, in Federal Realty's opinion, a necessary term).

The trial court ruled, and the Appellate Court confirmed, that there was a binding agreement between the parties when they signed the "Final Proposal." The Court focused on the words that the nine terms in the Final Proposal were *"accepted by the parties."* The Court also discussed the title of the Final Proposal and the fact that it was not a letter of intent, which connotes a non-binding agreement. In this case, the parties had passed back and forth several documents labeled "Proposal," "Counter-Proposal," and "Revised Proposal." The courts have long held that an agreement is not unenforceable merely because it is subject to the approval of a formal

agreement. In this case, the name of the document, the "acceptance language" and the omission of the non-binding language that was in the earlier drafts persuaded both the trial court and the Appellate Court that the Final Proposal was a binding agreement.

The Court also addressed the claim by Federal Realty that the term of the Ground Lease was not stated, therefore the Final Proposal couldn't be enforced. The Court concluded that, since both the put and the call provisions had ten-year terms, the trial court had sufficient evidence in interpreting the Final Proposal to conclude that the term of the Ground Lease was intended to be ten years.

Result: The trial court's judgment of $15,901,274 was upheld, and that amount has continued to earn interest at the rate of ten percent per year since April, 2008, and is now over $20M! And, First National retained the building (which it has since sold).

Lesson: Make sure when you sign a letter of intent, memorandum or other interim document that you either are clear that it is non-binding, or, if it is to be binding, you have included all of the necessary terms and conditions.

Without providing legal advice, the following is sample non-binding letter of intent language that we have provided to participants at our Letter of Intent seminars:

Non-Binding Letter of Intent Provision with No Obligation to Use Good Faith:

Notwithstanding any other language of agreement that may appear elsewhere in this non-binding letter of intent, it is expressly understood and agreed that this letter of intent does not and shall not constitute a binding agreement between the parties in any manner, but only reflects proposed terms of a transaction which may become acceptable to the parties when fully documented and signed by all of the appropriate parties to such documentation. No party shall be bound to buy or sell the property unless and until the formal purchase agreement is executed by all of the parties and delivered to one another. It is intended that the formal purchase agreement shall contain other material terms, covenants, conditions, warranties and representations as may be acceptable to the parties which are not included herein. Prior to the execution of the formal purchase agreement by all appropriate parties, no actions or statements

by any party, nor any conduct by any party, shall create a binding agreement.