Be Careful When You Propose

You May Be Bound

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It's just another day at the office. You are presented with a signed single-page document captioned "Final Proposal" containing eleven short sentences which you can read in less than 60 seconds. The proposal says your company will lease property for $100,000 per month and give the proposed lessor a 10-year put option that would force your company to buy that property for a seven-figure sum. The last sentence says the noted terms are accepted by the parties subject only to approval of the terms and conditions of a formal agreement. The proposal has been signed by the proposed lessor and there is a blank for you to sign as the proposed lessee. It sounds like an interesting deal that might be worth pursuing. Do you sign the "Final Proposal" and attempt to work out a formal agreement? If you do, are you on the hook? What if you never come to terms on a formal agreement? According to a recent Ninth Circuit Court of Appeals case, if you sign the proposal you had better get out your checkbook. The court in *First National Mortgage Co. v. Federal Realty Investment Trust*, 631 F.3d 1058 (9th Cir. 2011) recently faced this scenario and ruled that the "Final Proposal" was, indeed, a binding agreement.

Federal Realty Investment Trust ("Federal Realty"), a real estate investment trust, and First National Mortgage Company ("First National") entered into the "Final Proposal" described above.

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6. Termination Rights.

The lease provides construction milestones and gives the tenant a right to terminate the lease if milestones are not met. This option works best for short-term construction projects or for tenants who can make alternate space arrangements without long lead time. The landlord will want to be sure the milestones are achievable and at least allow extension for force majeure. The lender may want extended cure periods to provide time for foreclosure if the lender must gain possession of the property to perform the landlord's obligations under the lease.

The issue of security for the landlord's TI obligations involves many competing concerns. The best option for a particular deal will depend on the specific facts in play. In order to minimize delay and keep lease negotiations running smoothly, landlords, tenants and lenders should think about this issue early and should position themselves for a swift resolution that balances the competing concerns of all parties.

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Federal Realty was in the midst of developing Santana Row, one of the nation's largest mixed-use projects, and sought to acquire nearby property owned by First National. The Final Proposal did not state an express term for the ground lease, but it did give First National a 10-year "put" option that would require Federal Realty to purchase the property at a specified price at any time during the 10-year term. It also gave Federal Realty a "call" option that would require First National to sell Federal Realty the property at the end of 10 years. Other terms of the Final Proposal included that First National would be reimbursed for buying out the current lease on the property and that Fidelity Realty was to prepare a legal agreement for First National's review.

The parties engaged in extensive, but ultimately unsuccessful, negotiations toward a formal agreement which included discussions of possible lease terms of 34 and 50 years and a possible outright sale to Federal Realty. When First National demanded reimbursement for its buy-out of the current tenant, Federal Realty told First National that because the parties had a number of unresolved business issues, there was no binding agreement between them. First National sued Federal Realty for anticipatory breach of the Final Proposal. A jury found the Final Proposal to be an enforceable agreement, and that the put and call options could be interpreted to set a ground lease term of 10 years. The court awarded First National damages of almost $16 million – $10.6 million for lost rent for the ground lease and $5.2 million for Federal Realty's breach of the put option.

Federal Realty appealed. The appeals court affirmed and agreed with the trial court that the Final Proposal was a binding agreement. The court stated that an agreement is not unenforceable merely because it is subject to the approval of a formal contract. According to the court, calling something a "proposal," instead of a "contract" or a "lease," does not necessarily mean it was not meant to be binding, especially where the circumstances suggest otherwise. The court distinguished a case in which the document at issue was called a "letter of intent" and pointed out that the Final Proposal in this case specifically omitted Federal Realty's standard non-binding clause, which it had inserted in earlier drafts.

The critical lesson from the *First National Mortgage* case is that until you are absolutely certain you are ready to bound to a deal (whether for a lease, loan or sale) make sure that any

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document containing deal terms which precedes a formal written agreement is clearly labeled as being only a "letter of intent" and includes non-binding language such as:

"This letter of intent is not intended to constitute a binding agreement or contract, but rather to state the preliminary intentions of the parties with respect to negotiating a definitive written agreement between the parties. It is understood and agreed that this letter of intent does not contain all the essential terms that the parties expect will be part of such an agreement and neither party shall have any obligation or liability to the other unless and until the parties enter into such a written agreement containing all essential terms and conditions the proposed transaction."

Letters of intent and proposals in real estate deals should never be taken lightly. They provide a great tool for relatively low-cost negotiations of major deal points, but if handled incorrectly, they can trap the unwary. Be sure to check with an attorney to ensure that the document you are signing has the legal consequences you or your company intend.

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