

Deal or No Deal? - Letters of Intent

Lessons from the Enterprise Case

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A \$469,375,000 Million Dollar trial court verdict based on a “letter of intent,” later reversed on appeal resonates in the real estate industry, where letters of intent are commonplace.

How it started: Enterprise Products, a Houston based pipeline developer/operator approached Energy Transfer, a Dallas based competitor, to investigate a shared development transaction to transport oil from the important industry storage center in Cushing, Oklahoma to Houston, thereby eliminating a major logistics bottleneck. They signed the following documents for the proposed “Double E Pipeline”:

- Initially, a Confidentiality Agreement to permit sharing of information, with the intention to work toward a letter of intent for the proposed transaction.
- Then, a Letter of Intent with typical non-binding language and an attached “Term Sheet” outlining a proposed 50/50 joint venture pipeline, if sufficient market interest resulted in customer commitments within an “open season” for solicitations.
- Shortly thereafter, a Reimbursement Agreement in which they agreed to share costs in “fast tracking” the engineering for the proposed pipeline.

What went wrong:

The anticipated market was not there, at least at the pricing required for the Double E. After the open season closed, Enterprise terminated the Double E, based on language in the Letter of Intent stating that “no binding obligation is created.” Enterprise immediately moved to a similar project with Enbridge, which owned a pipeline from Canada to Cushing, OK, which could be paired with the new pipeline to generate greater market acceptance. Enterprise and Enbridge had met shortly before the end of the open season for the Double E, but deferred substantive discussions until afterward. Energy Transfer sued, claiming a legally binding partnership was created by the Letter of Intent and related documents, and that Enterprise breached its duty of loyalty to its partner, bringing up memories of the infamous *Texaco v. Pennzoil* case where the court found a binding contract despite Texaco asserting a non-binding letter of intent.

What the Letter of Intent said: The letter outlined a potential development transaction, including an attached “Term Sheet” with business terms. It also contained the following typical letter of intent provision:

“Neither this letter nor the JV Term Sheet create any binding or enforceable obligations between the Parties and ... no binding or enforceable obligations shall exist between the Parties with respect to the Transaction unless and until the Parties have received their respective board approvals and definitive agreements memorializing the terms and conditions of the Transaction have been negotiated, executed and delivered by both of the Parties. Unless and until such definitive agreements are executed and delivered by both of the Parties, either [Enterprise] or ETP, for any reason, may depart from or terminate the negotiations with respect to the Transaction at any time without any liability or obligation to the other, whether arising in contract, tort, strict liability or otherwise.”

The endeavor of the parties was divided in 2 phases:

- A preliminary investigation stage to determine if the development was economically viable, to preliminarily design the project, and seek sufficient market commitments.
- The development and operation of the project.

\$469,375,000 Million Trial Court Verdict for Energy Transfer: Energy Transfer pitched the project as a “done deal,” and that Enterprise conspired with Enbridge to cut Energy Transfer out of the deal, breaching a duty of loyalty to its partner. The President of Energy Transfer testified that sometime in May 2011, the proposed project became a legally binding joint venture (a type of partnership). The Reimbursement Agreement provided for payments from Energy Transfer to Enterprise, which was legally enforceable. Energy Transfer pointed to well settled Texas Law that a partnership may be created verbally and that only a few terms must be agreed, being:

- That the parties will be partners
- Each partner has power to participate in management
- Each partner must contribute money or property
- The partners share profits and losses (not necessarily on an equal basis).



Enterprise insisted that without the satisfaction of the conditions precedent in the letter of intent (which was not contested), there could be no partnership. However, the Trial Court ignored the conditions precedent.

Once the jury found a legal partnership, the damages followed, in this case, \$469,375,000 million!

Why the Appellate Court Reversed: The Appellate Court said that the Trial Court forgot that general concepts of law still apply to partnerships, such as the requirement to satisfy any conditions precedent in the letter of intent. Conditions precedent are any requirement contained in an agreement which must be satisfied. Conditions precedent are common in business agreements. In this case, unless the conditions were waived, there is no partnership. Waiver is the intentional relinquishment of a right. Waiver can be express or implied (by conduct inconsistent with the condition precedent). Energy Transfer stated that there was waiver, but all the examples given were ambiguous, and insufficient. Therefore, Enterprise was vindicated.

Was this case unexpected? Yes, but not the Appellate Court's treatment, which is consistent with Texas law, as well as business practices. The Trial Court's judgement was the surprise, given the clear drafting in the letter of intent (and the related and consistent provisions in the other 2 documents). In Texas, a non-binding letter of intent is non-binding, barring waiver by inconsistent conduct (not found in the Enterprise case).

Why should the Real Estate Industry care? Letters of intent are pervasive in our industry. Most lease and purchase/sale transactions are initiated by letters of intent of various form and detail. These letters of intent are intended to be non-binding outlines of the business points of a proposed legal transaction. Their use is to save time and cost by focusing the parties on "agreeing" (but not in a legally binding sense) on business terms, so that the parties can then shift to drafting and negotiating the legally binding documents, usually a lease or purchase and

sale agreement, usually with extensive and detailed contractual provisions. No party initiates a real estate transaction intending to be legally bound by an outline of a deal in a non-attorney drafted letter of intent.

What is scary about the Enterprise case? It should be a wakeup call to the industry to see that a \$469,375,000 million verdict was supported by a letter of intent with typical non-binding language, even if you add in the related confidentiality agreement and reimbursement agreement, documents also creeping into real estate transactions. Sloppy drafting of letters of intent and/or inconsistent actions after executing a letter of intent could result in a legally binding agreement between parties who initially expected their business relationship to be better defined by carefully drafted and negotiated contract documents, not a summary document like a letter of intent.

Lessons for Letters of Intent:

DRAFTING:

- You can't say "non-binding" enough in a Letter of Intent!
- Use the title "Non-binding Letter of Intent".
- Include the term at the beginning and end of the letter
- Use the term in the substantive provisions in the body of the letter.

STATE CLEARLY:

- Conditions precedent to a binding transaction and use the term "conditions precedent."
- Nothing is binding until formal transaction documents are signed.
- The letter of intent is to document the investigation of a proposed transaction.
- Ancillary documents, like the confidentiality or reimbursement agreement in the Enterprise case,

should be drafted consistent with the non-binding character of the primary letter of intent, even though the ancillary documents have legally binding obligations.

ACTIONS AFTER SIGNING A LETTER OF INTENT:

- Act and speak consistent with the non-binding nature of the transaction.
- The terms "proposed", "prospective", "possible" should be liberally used.
- Refrain from overly optimistic statements which have imbedded assumptions that the deal is complete and only "details" remain.
- Watch what is said in email- Remember that email lives forever and will be admissible at a trial!
- Don't waive conditions precedent.
- Be limited in public statements.
- Don't announce "We have a deal".
- Watch press releases.

BEWARE OF "BACK-UP" DEALS.

- Beware of substantive discussions with other parties for the same real estate or leased premises prior to terminating a pending letter of intent.
- Think how actions could look to a jury, even if not legally relevant.

Letters of intent serve important functions of outlining proposed real estate transactions before the parties are required to hire lawyers to draft final legally binding transaction documents. However, the Enterprise case shows that if the proposed transaction is terminated by one party, the other might assert the letter of intent and negotiations following constitute a binding deal. Carefully drafting and moderation of actions during the letter of intent period will help insulate parties from legal liability if the letter of intent does not result in a successful transaction. ■