

SLF Alert

- The intent behind a preliminary contract may determine its binding power.
- Boiler plate “agreements to agree” may not bind parties.
- The intention to create a binding preliminary contract is objective, from the view of a reasonable person well versed in the relevant transaction.

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In a constantly evolving financial climate, it is likely that parties will seek to avoid agreements reached with other parties that are no longer profitable or commercially viable. Such refusal to abide by agreements leads to disputes between parties, often over one issue: whether the agreement was binding and enforceable.

Amcan Holdings v. Canadian Imperial Bank of Commerce

In a recent case in New York, *Amcan Holdings, Inc. v. Canadian Imperial Bank of Commerce*, 2010 NY Slip Op 00786, (“*Amcan*”), the Appellate Division of the Supreme Court of New York concluded that an executed “Summary of Terms and Conditions,” which delineated a proposed financing between lender and borrower, was not a formally binding agreement – but an “agreement to agree.” Federal cases cited by the Court discussed two forms of preliminary contracts: (1) a contract which occurs when parties have reached an agreement on all issues that may need negotiation; and (2) a preliminary agreement that expresses mutual commitment to contract while noting that there are further terms to be negotiated. *Teachers Insurance and Annuity Association of America v. Tribune Company*, 270 F. Supp. 491, 498 (S.D.N.Y. 1987).

Per federal case law, the former type of preliminary contract is binding on the parties while the latter only binds parties to negotiate the remaining issues.

However, *Amcan* rejected this approach and considered two critical components: (1) where the parties contemplated subsequent agreements; and (2) if those contemplated agreements were a necessary condition to performance on the contract. If in fact there were such subsequent agreements to be made, the Court decided that the parties did not intend to be bound by any agreement until all documentation was finalized.

***Amcan* Outside the Lender/Borrower Spectrum**

With the knowledge of the *Amcan* decision, the first question parties should ask is how a reasonable person

versed in the relevant transaction would understand the exchange between the parties. If the contract is boilerplate, set up to indicate that a later contract would be binding, industry custom may indicate that it is not binding on its own. However, if an agreement was reached with the intention that it would bind the parties involved – through an action as a minor as a one line written statement to finalize the contract at a later date – courts may find it binding. Often, the industry perception of a preliminary agreement or contract is the deciding factor regarding its validity.

Intention to Be Bound in a Legal Agreement

The last thing courts want to enforce is a “surprise” contract, where parties have no intention of being bound in a contract in the first place. Outside of borrower/lender agreements, such preliminary contracts can occur during potential company buy-outs, investor agreements, and even contracting/employee agreements. Parties may enter a preliminary agreement to work together, with the details of the contractual agreement to be decided and finalized at a later date. In these situations, the intention of the parties matters: (1) was the preliminary agreement a promise to contract? or (2) did the parties reach an understanding that the agreement was to further discussion, but not binding? or (3) was the contract boilerplate, or was it customized?

Precautionary Measures

Amcan does not mean open season on preliminary contracts. It in fact serves as a cautionary example for parties discussing a mutual understanding and agreement. The idea being: delineate your intentions in the contract, both if you want to be bound or create an “out” clause if you do not want to be bound. For more information, please contact Sheheryar T. Sardar at Sardar@sardarlawfirm.com.

This information is not intended as legal advice. The issue discussed here is general and may not be applicable in all situations; it must not be taken as legal advice.