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Term Sheets: When Are Parties Bound?

Parties negotiating business transactions often find it useful to memorialize key provisions they have agreed upon in a term sheet. Sometimes the parties will sign at the bottom. When doing so, they may have very different expectations about whether their term sheet is enforceable, particularly where the parties contemplate a later written agreement that is not ultimately executed. An agreed term sheet may lead to an unwelcome surprise for a party that thinks nothing is binding until a full-blown contract is signed.

The ubiquity of term sheets as a tool in the deal process raises important questions regarding whether and when term sheets are binding, particularly where it is unclear if the parties intended to bind themselves.

This article lays out the guideposts the New York courts have established on these questions. The only clear rule is that if the term sheet states expressly that the parties will not be bound until a formal agreement is signed, there is no enforceable agreement. Absent such express language, there is no bright-line rule that dictates whether a term sheet is enforceable. Instead, courts will look to the parties' intent and the surrounding circumstances, to determine whether a binding contract was formed.

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By **Erik Groothuis**

If the term sheet states expressly that the parties will not be bound until a formal agreement is signed, there is no enforceable contract. "[I]f the parties to an agreement do not intend it to be binding upon them until it is reduced to writing and signed by both of them, they are not bound and may not be held liable until it has been written out and signed" *Scheck v. Francis*, 26 N.Y.2d 466, 469-70 (1970). Certainly, "when a party gives forthright, reasonable signals that it means to be bound only by a written agreement, courts should not frustrate that intent." *Stonehill Capital Mgmt. v. Bank of the W.*, 2016 NY Slip Op 08481, ¶ 7 (2016).

The only clear rule is that if the term sheet states expressly that the parties will not be bound until a formal agreement is signed, there is no enforceable agreement.

This means that provided that the parties clearly disclaim any intent to be bound, the courts will not interfere. See, e.g., *Keitel v. E*TRADE Fin.*, 2017 NY Slip Op 06624, ¶ 1 (1st Dept. 2017) (term sheet that "sets forth the general intent of the parties to discuss in good faith the terms and conditions" of the deal and further that "neither party shall be bound until the parties execute a more formal written agreement" does not constitute an enforceable contract).

There is good reason for this. As the First Department has explained, "[T]he concept of freedom of contract includes the '[f]reedom to *avoid* oral agreements,' a freedom that 'is especially important when business entrepreneurs and corporations engage in substantial and complex dealings' … We think it preferable to allow sophisticated parties operating in the business world to decide when and how they wish to enter into legally enforceable contracts." *StarVest Partners II, L.P. v. Emportal*, 2012 NY Slip Op 9145, ¶ 3 (1st Dept. 2012).

Thus, it is clear that a mere "agreement to agree," in which material terms are left to future negotiations, is not enforceable. *Tractebel Energy Mktg. v. AEP Power Mktg.*, 487 F.3d 89, 95 (2d Cir. 2007). A party that does not wish to be bound by a term sheet should always be sure to include express language disclaiming any intent to be bound until the parties execute a formal written agreement.

A term sheet or oral agreement may be binding in the absence of a formal contract, provided there are no material terms left open for negotiation. What happens, however, when parties do want some or all terms in a term sheet to bind them? Or if they have agreed on all the material terms, but still contemplate a formal signed contract without expressly disclaiming an intent to be bound? The Court of Appeals has said as follows:

> Generally, where the parties contemplate that a signed writing is required there is no contract until one is delivered (*Scheck v Francis*, 26 NY2d 466; *Schwartz v Greenberg*, 304 NY 250). This rule yields, however, when the parties have agreed on all contractual terms and have only to commit them to writing. When this occurs, the contract is effective at the time the oral agreement is made, although the contract is never reduced to writing and signed. Where all the substantial terms of a contract have been agreed on, and there is nothing left for future settlement, the fact, alone, that it was the understanding that the contract should be formally drawn up and put in writing, did not leave the transaction incomplete and without binding force, in the absence of a positive agreement that it should not be binding until so reduced to writing and formally executed (*Disken v Herter*, 73 App Div 453, *affd* 175 NY 480; 1 Williston, Contracts, §28; *see, also, Matter of Meister*, 39 AD2d 857, *affd* 32 NY2d 626; *Belmar Contr. Co. v State of New York*, 233 NY 189, 194).

Mun. Consultants & Publishers v. Ramapo, 47 N.Y.2d 144, 148-49 (1979); see also *Zucker v. Katz*, 836 F. Supp. 137, 144 (S.D.N.Y. 1993) ("where the parties do not intend that an agreement must be reduced to writing to be binding, and there are no material terms of the contract left open for negotiation, an informal oral agreement may be binding even if the parties contemplate memorializing their agreement in writing").

Federal courts interpreting New York law have developed guidance to assist courts in answering these questions.

> The Second Circuit has set forth four factors to determine whether the parties intended to be bound prior to executing a written contract; namely, whether: (1) either party has expressly reserved the right not to be bound absent a written agreement; (2) there has been partial performance of the contract; (3) all of the terms of the alleged contract have been agreed upon "such that there is literally nothing left to negotiate or settle;" and (4) the agreement at issue is the type of contract that is generally committed to writing. *R.G. Group, Inc. v. Horn & Hardart Co.*, 751 F.2d at 75-76; *see also Winston v. Mediafare Entertainment Corp.*, 777 F.2d at 80.
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> *Zucker*, **836 F. Supp. at 144.**

What all this means is that if the parties unambiguously provide that a term sheet will not be binding, courts will respect that choice. If the rule were otherwise, term sheets would lose their utility because they would have the same legal effect as final contracts.

This means that courts will enforce agreements, even term sheets or informal oral agreements that contemplate a formal written contract, if the parties have agreed upon the material terms. See *Knopf v. Sanford*, 123 A.D.3d 521, 521-22 (App. Div. 1st Dept. 2014) (even though parties anticipated the execution of a more formal writing, where they evidenced a clear intent to be bound in the interim, the parties were bound); *Bed Bath & Beyond v. Ibex Constr.*, 52 A.D.3d 413, 414 (1st Dept. 2008) (parties will be bound by letter of intent that manifested binding intent and was not subject to an express reservation of right explicitly saying otherwise).

Takeaways

What all this means is that if the parties unambiguously provide that a term sheet will not be binding, courts will respect that choice. If the rule were otherwise, term sheets would lose their utility because they would have the same legal effect as final contracts.

But if the parties do not express their intent not to be bound clearly, courts will consider several factors—including whether the parties partially performed the agreement and whether all material terms have been agreed upon—in evaluating a term sheet's enforceability. In those circumstances, parties may well be bound even if the term sheet contemplates a future "definitive" contract.

To avoid litigation, negotiating parties should carefully consider whether, and to what extent, they would like to be bound when drafting and signing term sheets. Term sheets can be a useful tool, provided everyone understands the rules of the road.