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NOTES

CONTRACTS—THE TREND TOWARD LEGAL REALISM. *Shearson Lehman CMO, Inc. v. TCF Banking & Savings*, 710 F. Supp. 67 (S.D.N.Y. 1989). *Teachers Insurance & Annuity Association v. Tribune Co.*, 670 F. Supp. 491 (S.D.N.Y. 1987).

Shearson Lehman CMO, Inc. (hereinafter Shearson), a subsidiary of Shearson Lehman Hutton, Inc., purchases mortgage backed certificates guaranteed by various federal agencies. Government agencies create the certificates by purchasing mortgages from lenders¹ and then selling the right to the cash flow from a small portion of these mortgages. The certificates themselves are secured by the mortgages, while the mortgages are secured by the actual properties.² Shearson finances these transactions by selling collateralized mortgage obligations (CMOs) secured by the mortgage certificates.³

On March 5, 1987, TCF Banking and Savings (hereinafter TCF) and Shearson reached an agreement whereby TCF would buy 49% of the residual interest in a CMO trust.⁴ A specific internal rate of return and the formula for calculating such rate of return on the bonds was agreed to by both TCF and Shearson. Soon after, Shearson sent TCF a mockup of a financial advertisement describing the purchase.⁵ TCF

1. *Shearson Lehman CMO, Inc. v. TCF Banking & Sav.*, 710 F. Supp. 67 (S.D.N.Y. 1989). The lenders consist of such institutions as commercial banks or savings and loan institutions. *Id.* at 69.

2. *Id.*

3. *Id.* The court provided the following explanation:

CMOs convey the right to obtain a portion of the cash flow from a pool of mortgage backed certificates. The CMOs issued to buy a specific group of mortgage backed certificates are referred to collectively as a CMO trust, and usually last for a specific period of time However, the cash flow from a given pool of mortgage backed certificates often is well in excess of what is required to pay off the CMO holders. What is left over is called the residual cash flow. A CMO residual is simply the right to receive that excess cash flow over the life of the CMO trust.

Id.

4. *Id.* The particular trust TCF invested in consisted of Shearson Mortgage Backed Sequential Pay Bonds known as Series G CMO residuals. *Id.*

5. A mockup is also known as a tombstone ad which is merely an announcement of a stock

changed three words in the mockup and returned the advertisement to Shearson. In addition, Shearson sent TCF a draft private placement memorandum⁶ and purchase agreement. After TCF reviewed the drafts, TCF discovered the deal with Shearson would result in various unforeseen tax and accounting problems. As a result of these problems, TCF refused to buy the residuals.⁷

As a result of TCF's refusal to perform, Shearson sued for breach of contract. Shearson alleged that its March 5, 1987 conversation with TCF constituted a valid oral agreement. Shearson also asserted promissory estoppel to prevent TCF from denying the existence of a contract.⁸ In granting TCF's motion for summary judgment, the district court determined that the parties never considered the March 5, 1987 conversation to be an oral contract.⁹ In addition, the court rejected Shearson's promissory estoppel claim by finding that TCF's promise to purchase 49% of the CMO residuals was unclear and ambiguous.¹⁰ *Shearson Lehman CMO, Inc. v. TCF Banking & Savings*, 710 F. Supp. 67 (S.D.N.Y. 1989).

Teachers Insurance and Annuity Association (hereinafter Teachers) is an organization which furnishes pension annuities and insurance programs to educational institutions. Tribune Company (hereinafter Tribune) is a communications conglomerate that owned the New York Daily News.¹¹ In the spring of 1982, Tribune decided to restructure its News subsidiary. As a result, Tribune acquired a nonrecurring tax loss of \$75 million.¹² Therefore, Tribune decided to sell the News Building. Tribune felt it imperative to sell the building in 1982 so that the loss realized from the restructuring could be offset against the taxable gain realized from the sale of the building.¹³

In anticipation of selling the News Building, Tribune circulated an

offering. It is not used as a selling tool. BLACK'S LAW DICTIONARY 1334 (5th ed. 1979).

6. 710 F. Supp. at 69. The private placement memo was sent pursuant to § 4(2) Securities Exchange Act of 1933, 15 U.S.C. § 77(d)(2)(1982). A private placement memorandum is a memorandum in which a corporation offers to sell its stock to private persons outside of a public offering. BLACK'S LAW DICTIONARY 1076 (5th ed. 1979).

7. 710 F. Supp. at 69.

8. *Id.*

9. *Id.* at 73.

10. *Id.* at 74.

11. *Teachers Ins. & Annuity Ass'n v. Tribune Co.*, 670 F. Supp. 491, 492 (S.D.N.Y. 1987).

12. *Id.* at 492. The important feature of Tribune's proposal was the idea of offset accounting whereby Tribune would have the loss from restructuring the company offset from the gain of selling the building. *Id.*

13. *Id.*

offering brochure to potential investors.¹⁴ Teachers was one of the investors who received Tribune's brochure. Discussions ensued between Tribune and Teachers in which both parties made clear their expectations. Tribune emphasized its need for offset accounting and a firm commitment by September 15, 1982.¹⁵

On September 16, 1982, Tribune was told that Teacher's Finance Committee met and discussed the purchase of the building on the terms outlined in the offering brochure.¹⁶ The Committee approved the purchase and informed Teachers it would soon receive a commitment letter. The draft of the letter and a two page term sheet was mailed on September 22.¹⁷ The term sheet outlined the fundamental economic terms of the loan as covered in Tribune's proposal; however, neither the term sheet nor the commitment letter reflected Tribune's requirement of offset accounting.¹⁸ The letter stated that once Teachers received an accepted counterpart of the commitment letter, a binding agreement between the two parties would be formed.¹⁹ When Tribune received the letter with the binding language, its lawyers advised against signing the documents. However, Tribune had been turned down by five other institutions and did not want to lose the commitment.²⁰

Tribune's board of directors met on October 28. At this meeting, the board adopted resolutions authorizing the proper officers of the company to execute the loan.²¹ In November, Tribune's accountants

14. *Id.* at 493. The brochure consisted of 50 pages describing the proposed mortgage and loan on the building along with pertinent financial information on the Tribune and the building. "The brochure included two term sheets—one describing the proposed money purchase money mortgage Tribune would receive upon the sale of the Building, the other giving the terms of the proposed match-fund borrowing." *Id.* The match fund would occur when Tribune borrowed from a third party an amount approximately equal to the mortgage note. *Id.* at 492.

15. *Id.* at 493. Teachers informed Tribune there could be no firm commitment before approval of the deal by Teacher's Finance Committee which would not meet until September 16. Tribune accepted the delay. *Id.*

16. *See supra* note 14 and accompanying text.

17. 670 F. Supp. at 494. The draft of the letter included a two page summary of the proposed terms drawn from the term sheet included in Tribune's offering brochure and the ensuing conversations between Tribune and Teachers. *Id.*

18. *Id.* In essence, the letter stated the agreement was dependent on preparation, execution, and delivery of documents satisfactory to Teachers and Teachers' counsel. *Id.*

19. *Id.*

20. *Id.* Tribune signed the letter without commenting on the absence of offset accounting. However, Tribune sent an accompanying letter to Teachers in which it stated acceptance was conditional on approval by the Tribune's board of directors and the preparation of satisfactory legal documentation of the deal. *Id.*

21. *Id.* at 495. The resolutions also stated that the actual terms and conditions of the agreement were subject to prior approval by a resolution of the Finance Committee. *Id.*

became concerned about the offset accounting issue.²² Teachers and Tribune held meetings and negotiations regarding the concerns of offset accounting.²³ Meanwhile, interest rates quickly fell below those rates effective in August when Teachers and Tribune entered into the commitment.²⁴ Nonetheless, Tribune executed and returned the loan documents.²⁵

In late October 1982, Teachers informed Tribune that its Board had given general approval to the transaction.²⁶ Around December 2, Tribune began making various changes to the transaction including making the deal conditional on offset accounting. However, Teachers would not agree to the proposal. On December 6, Teachers pressured Tribune to finalize the loan documents. Teachers also asked Tribune to have a meeting to work out the open terms.²⁷ Tribune responded that without the availability of offset accounting, there was no point in negotiating further.²⁸ In response, Teachers sent Tribune a letter extending the commitment for thirty days. However, Tribune exhibited no further interest in pursuing the transaction.²⁹ Teachers brought this action against Tribune charging Tribune with breach of their commitment agreement for a fourteen year \$76 million loan.³⁰

The district court held that the commitment letter represented a binding preliminary agreement.³¹ The agreement obligated both parties to try to reach a final loan agreement including terms already agreed upon, while negotiating in good faith to resolve the minor additional

22. *Id.* In mid-October, the Financial Accounting Standards Board issued an exposure draft discussing the appropriateness of offset accounting. Tribune's accountants also became concerned that if Tribune proceeded to offer securities to the public, the SEC in commenting on the Registration Statement might ask the accountants for an opinion on the "preferability" of offset accounting. The accountants did not feel they could give such an opinion. Without such an opinion, the SEC might not allow the liability to be kept off the balance sheet. *Id.*

23. *Id.* at 495-96.

24. *Id.* at 496.

25. *Id.* at 495. Tribune added to the letter that the commitment was subject to modifications set out in the accompanying letter. The modifications consisted of the acceptance being subject to the right of approval by Tribune's Board of Directors. The acceptance letter did not mention offset accounting. *Id.*

26. *Id.* at 496.

27. *Id.* The open terms consisted of relatively minor economic significance, i.e. events of default, representations and warranties, closing conditions, and terms of payment. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

31. *Id.* at 499.

terms which are "usual and customary" in the industry.³² Moreover, Tribune's reservation of right of approval to its board of directors did not leave it free to abandon the transaction.³³ *Teachers Insurance & Annuity Association v. Tribune Co.*, 670 F. Supp. 491 (S.D.N.Y. 1987).

A fundamental concept of contract law was well expressed by Justice Learned Hand in *National City Bank v. Hotchkiss*.³⁴ Hand stated that "the secret intentions of a contracting party, even when attested to by 20 bishops, will not be given force in a contract."³⁵ The common law of contracts assumes a clear distinction between "contracts" and "negotiations of a contract."³⁶ The distinction lies in the fact that under a contract, each party has an enforceable right against the other.³⁷ "The person who becomes a party to a contract assumes a duty to go forward with the contemplated transaction."³⁸ The contractor's freedom of action is restrained in that if he does not go forward with the contract, he could be guilty of a breach.³⁹ Therefore, until a contract is reached, no rights exist because none have been created, and neither party has a duty to go forward with the contract.⁴⁰

The outcome of a contract negotiation situation under the traditional common law categories leaves only two results: either a contract was formed or a contract was not formed.⁴¹ Under the traditional analysis, there is no room for preliminary binding agreements.⁴²

32. *Id.*

33. *Id.*

34. *Shearson Lehman CMO, Inc.*, 710 F. Supp. at 70 (citing *National City Bank v. Hotchkiss*, 231 U.S. 50 (1913)).

35. *Id.*

36. Knapp, *Enforcing the Contract to Bargain*, 44 N.Y.U. L. REV. 673, 676 (1969).

37. *Id.*

38. See *infra* note 39 and accompanying text.

39. Knapp, *supra* note 36, at 676. The duty to go forward could be inchoate or it could be dependent on initial performance of the other party. Once the duty to go forward exists, the contractor is no longer free to abandon the contract. In essence, even a statement of intention to abandon the contract may amount to an immediate breach. *Id.*

In contrast, a party who is not bound by a duty to perform the contract may abandon the proposed transaction at any time and for any reason. An unbound party remains free to enter into another contract of a similar nature with a third party, or refrain from action altogether. Either way, the unbound party is not accountable to the abandoned party for any disappointment of expectation. Knapp, *supra* note 36, at 676.

40. Knapp, *supra* note 36, at 676.

41. Knapp, *supra* note 36, at 676.

42. Knapp, *supra* note 36 at 676-77. However, there is a great likelihood that many situations would arise where the parties' obligations would fall in between the two extremes at some stage of the negotiation. Knapp, *supra* note 36, at 676.

However, carved into the rigid rules of common law is the concept of "legal realism."⁴³ Legal realism allows the court to examine the parties' "moral" or "ethical" conduct with respect to the transaction at issue.⁴⁴ In essence, legal realism provides a middle ground between the stringent common law categories of contract and no-contract.⁴⁵

Legal realism weakens the rigid common law rule that a binding agreement between parties to a prospective transaction can exist only if there are reciprocal rights and duties.⁴⁶ The best example of legal realism slowly chipping away at traditional contract law is the Uniform Commercial Code (U.C.C.).⁴⁷ The U.C.C. represents the trend toward following the normal customs of conduct between businessmen in the marketplace and looking at the reality of the business transaction.⁴⁸

43. Knapp, *supra* note 36, at 675.

44. Knapp, *supra* note 36 at 675.

45. Knapp, *supra* note 36, at 675. The middle ground situations could potentially fall into two categories: agreement to agree or formal contract contemplated. There is significant evidence suggesting that old contract doctrines have been utterly useless to commercial life in this country since the Civil War. Mooney, *Commercial Law Jurisprudence*, 11 VILL. L. REV. 213, 254 (1966). A study conducted by Professor Stewart Macaulay suggests that the business world fears and distrusts both contract law and lawyers. As a result, contract law is seldom used by the business world. Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 55 AM. SOC. REV. 60, 61-65 (1963). Macaulay suggests that businessmen prefer to make contracts by relying on a "man's word in a brief letter, a handshake, or 'common honesty and decency,' even when the transaction involves 'legally enforceable contracts.'" *Id.* This preference includes the sentiment that commitments should be honored in full because a good businessman does not waltz on a deal or a product. *Id.* The common belief of some businessmen is that legalistic contracts do not allow for "flexibility" in dispute settlements. In fact, businessmen invoke the law of contracts as a last resort. *Id.*

46. Knapp, *supra* note 36, at 676.

47. Knapp, *supra* note 36, at 678. The U.C.C. has been called "the most authoritative statement of current American commercial law."

48. Knapp, *supra* note 36, at 678-79. One commentator suggests that if the U.C.C. was expanded to cover business transactions, it would help solve the various business contract problems that frequently arise in business dealings. Project, *The U.C.C. and Contractual Law; Some Selected Problems*, 105 U. PA. L. REV. 836, 921 (1957). In addition, another author proposes that commercial law in this country is or will be the U.C.C. since it firmly grounds itself in the real life situations of business agreements. Mooney, *Commercial Law Jurisprudence*, 11 VILL. L. REV. 213, 220 (1966). The modern trend of enforcing business contracts must be grounded in the actual scenarios of modern economy, which depends heavily on credit transactions, and on transactions which are continuous by nature (e.g., vendor/vendee and stockbroker/client). The U.C.C. envisions such a modern approach to business transactions. *Id.* at 231.

"The traditional theory of contract will not hold up to the combined effect of the U.C.C. and an increasing awareness in society of the gap between contract theory and the reality of the socio-economic workings of our industrial democracy." *Id.* at 253. "The U.C.C. may not bridge the gap in one swoop. However, the U.C.C. rests in a threshold position between the traditional doctrine of contract and new jurisprudence and represents the essence of the legal realist movement in American law." *Id.* at 254.

Another example of legal realism replacing the traditional doctrine of contracts is the modern law of products liability.⁴⁹ Products liability principles developed out of a need of the modern consumer economy which was crippled by the orthodox doctrine of privity.⁵⁰

The modern view of precontractual liability centers around intentions of the parties to enter into an agreement, rather than the actual existence of an agreement.⁵¹ The courts focus on the oral or written agreement between the parties and then on the parties' subsequent actions to ascertain the parties' intentions.⁵² As a result, the courts are following a modern trend of softening traditional rules by looking at reality rather than the form of transaction.⁵³ Orthodox contract principles have developed into rules with emphasis on intent rather than form.⁵⁴ As preliminary agreements become the norm for many businesses, courts must solve the variety of problems that result when one party relied on a preliminary agreement, while the other party had no intention of being bound by such agreement.⁵⁵

Contractual liability arises from consent to be bound.⁵⁶ Fundamental to contract law is the rule that participation in negotiation does not give rise to a binding obligation.⁵⁷ However, the courts should enforce and preserve agreements where the parties intended a binding agreement even though the agreement requires further documentation or negotiation.⁵⁸ The key to determining when and whether a contract

49. Mooney, *supra* note 45, at 255. Product liability law developed from a blend of contract and tort law.

50. Mooney, *supra* note 45, at 255. Other examples of the invasion of legal realism into the modern society include collective bargaining agreements, pension and retirement plans, securities marketing systems, and private-law making contracts. The traditional theory of contracts seems to ignore the importance of \$80 billion in pension funds, the realities of a corporate equities distribution and exchange system involving millions of dollars daily. The traditional law cannot be taken seriously when evidence indicates that it is not only unnecessary but also dysfunctional.

51. Lake, *Letters of Intent: A Comparative Examination Under English, U.S., French, and West German Law*, 18 GEO. WASH. J. INT'L & ECON. 331, 338 (1984).

52. *Id.*

53. See *infra* note 67 and accompanying text. The cases therein exemplify how the courts took each fact situation on its own merits and evaluated the transaction in light of the reality of the transaction.

54. *V'soske v. Barwick*, 404 F.2d 495, 499 (2d Cir. 1968).

55. C. KAUFMAN, *CORBIN ON CONTRACTS* § 1 (Supp. 1989).

56. New York law on contract negotiations holds that enforceable legal rights do not arise until there is an expression of mutual consent to be bound or something to the equivalent to indicate acceptance of an offer. *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 497-98.

57. *Id.*

58. *Id.*

is formed is examining the parties' intentions.⁵⁹ The threshold question is whether the parties intended not to be bound prior to execution of a formal contract, or whether they contemplated that their informal agreement would be memorialized in writing at some future time.⁶⁰

Under modern contract law, there are two types of preliminary agreements with binding force.⁶¹ The first type of enforceable agreement involves a situation in which the parties have reached complete agreement (including the agreement to be bound) on all issues requiring negotiation.⁶² This type of agreement, known as a "formal contract contemplated,"⁶³ is preliminary in form only in the sense that the parties want a formalization of the agreement. However, the formalization is not necessary—only desirable.⁶⁴

Historically, the courts considered various factors, derived from a melting pot of case law, in deciding whether parties intended to be bound.⁶⁵ Eventually, the courts developed a four-part test to aid in determining the parties' intentions:⁶⁶ (1) whether there has been an express reservation of the right not to be bound in the absence of writing,⁶⁷ (2) whether there has been partial performance of the contract

59. See *infra* note 73 and accompanying text. *Winston v. Mediafare Entertainment Corp.*, 777 F.2d 78 (2d Cir. 1985); *R.G. Group, Inc. v. Horn & Hardart Co.*, 751 F.2d 69 (2d Cir. 1984); *Chrysler Capital Corp. v. Southeast Hotel Properties Ltd. Partnership*, 697 F. Supp. 794 (S.D.N.Y. 1988).

60. See *supra* note 59.

61. *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 498. Knapp, *supra* note 36, at 676.

62. 670 F. Supp. at 498. A preliminary agreement can simply be an agreement to be bound by such agreement. *Id.*

63. Knapp, *supra* note 36, at 676. Formal contract contemplated defines a situation in which the parties have reached full agreement on many or most of the terms of the contemplated transaction. In addition, the parties may desire a formalization of their agreement. However, the formalization is not a prerequisite to making the preliminary agreement enforceable. 670 F. Supp. at 498.

64. 670 F. Supp. at 498. Formalization may be desirable if the parties later want a written agreement paralleling their preliminary agreement. However, the absence of a written agreement would not make the preliminary agreement any less enforceable. *Id.*

65. *Banking and Trading Corp. v. Floete*, 257 F.2d 765, 769 (2d Cir. 1958). The court considered:

[W]hether the contract is of that class which are usually found to be in writing, whether it is of such a nature as to need a formal writing for its full expression, whether it has few or many details, whether the amount involved is large or small, whether it is a common or unusual contract, [and] whether the negotiations themselves indicate that a written draft is contemplated as the final conclusion of the negotiations.

Id.

66. *R.G. Group, Inc.*, 751 F.2d at 75-76; *Winston*, 777 F.2d at 80-84; *Chrysler Capital Corp.*, 697 F. Supp. at 800-03.

67. *R.G. Group, Inc.*, 751 F.2d at 75-76; *Winston*, 777 F.2d at 81-84; *Chrysler Capital*

and acceptance of the performance by the party disclaiming the contract;⁶⁸ (3) whether all of the terms of the alleged contract have been agreed upon;⁶⁹ and (4) whether the agreement at issue is the type of contract that is usually committed to writing.⁷⁰

Corp., 697 F. Supp. at 801-03. Courts consider this a clear signal of the parties' intentions. A party can make a statement not to be bound at any time during the course of bargaining or even at the time of the alleged agreement. *R.G. Group, Inc.*, 751 F.2d at 75 (The court found there was a clear understanding between the parties that they intended to be bound only by written agreement where the explicit wording of the franchise agreement declared on its face that when executed, the agreement would set forth the parties' rights and obligations, and any modification of the agreement would have to be written and signed). See *ABC Trading Co. v. Westinghouse Elec. Supply Co.*, 382 F. Supp. 600, 602 (Court rejected an alleged oral agreement because an earlier letter from one of the parties said that if the client finds the proposal agreeable in principle, they could proceed to reduce it to writing.); *Chromalloy Am. Corp. v. Universal Hous. Sys. of Am., Inc.*, 495 F. Supp. 544, 550 (S.D.N.Y. 1980) (Court found no oral contract under New York law when "correspondance between the parties not only refers to a written agreement, but expressly disclaims 'any intention to be bound until execution of such document.'"), *aff'd mem.*, 697 F.2d 289 (2d Cir. 1982); *Ashton v. Chrysler Corp.*, 261 F. Supp. 1009 (E.D.N.Y. 1965) (Court found no contract for dealership franchise when application said agreement must be signed and there was no signed agreement).

68. *R.G. Group, Inc.*, 751 F.2d at 75-76; *Winston*, 777 F.2d at 81-84; *Chrysler Capital Corp.*, 697 F. Supp. at 801-03. Partial performance sends an unmistakable signal that a party believes a contract exists. In addition, acceptance of such performance signals that the accepting party knows a contract was formed. *R.G. Group, Inc.*, 751 F.2d at 75-76; *Viacom Int'l Inc. v. Tandem Prod., Inc.*, 368 F. Supp. 1264, 1270 (S.D.N.Y. 1974) (Performance for a year is strong circumstantial proof that the minds of the parties had met on the essential elements and they were not waiting for formal written instruments.), *aff'd*, 526 F.2d 523 (2d Cir. 1975).

69. *R.G. Group, Inc.* 751 F.2d at 75-76; *Winston*, 777 F.2d at 81-84; *Chrysler Capital Corp.*, 697 F. Supp. at 801-03. The courts consider "whether there was literally nothing left to negotiate or settle, so all that remained to be done was to sign what had already been agreed to." *R.G. Group, Inc.*, 751 F.2d at 76; *Municipal Consultants & Publishers, Inc. v. Town of Ramapo*, 47 N.Y. 2d 144, 417 N.Y.S.2d 218, 390 N.E.2d 1143 (1979) (The court found a contract even though the document was not signed, since signing was authorized and was purely for administrative purposes).

70. *R.G. Group, Inc.*, 751 F.2d at 75-76; *Winston*, 777 F.2d at 81-84; *Chrysler Capital Corp.*, 697 F. Supp. at 801-03. Under this fourth factor, the courts examine "whether the agreement concerns those complex and substantial business matters where requirements that contracts be in writing are the norm rather than the exception." *R.G. Group, Inc.*, 751 F.2d at 76 (The court found that since the franchise agreement between the parties was to "run for 20 years and cover detailed matters of capital structure for the franchises, purchase and development of real estate, construction of stores, trade secrets, and transfers on default, it would be unusual for the transaction not to require a written agreement." In addition, the transaction involved an initial investment of two million dollars).

In *Reposystem, B.V. v. SCM Corp.*, 727 F.2d 257, 262-63 (2d Cir. 1984), the proposed deal involved a sale of six companies, incorporated in five different countries. The total sale price was \$4 million. Each company had assets of over \$17 million, sales of \$40 million, and profits of \$4 million. The deal also involved obtaining approval of foreign governments, selling both securities and assets, and transferring about 1,000 foreign employees. The complexity reflected a practical business need to record the parties commitments in definitive documents.

In applying the four-factor analysis, courts do not consider any single factor as decisive. Each factor merely provides insight into the parties' intentions.⁷¹ The intentions of the parties determine whether they agreed to bind themselves, with or without a formal agreement.⁷² Many courts have applied the four-factor analysis and found an enforceable preliminary contract.⁷³ In contrast, other courts have applied the four-factor test and found no binding agreement existed.⁷⁴

The second type of binding preliminary agreement is one which expresses mutual commitment to a contract on agreed major terms, while recognizing the existence of open terms that remain to be negotiated.⁷⁵ The open terms that remain to be negotiated must be within "the usual and customary terms" of a particular transaction.⁷⁶ Al-

In *Chrysler Capital Corp.*, 697 F. Supp. at 795, the court found that the transaction to purchase up to 15 Days Inn Hotels involving \$37,500,000 would usually close without signed and executed copies of such commitment.

71. *R.G. Group, Inc.*, 751 F.2d at 75; *Winston*, 777 F.2d 78; *Reprosystem, B.V.*, 727 F.2d 257; *Chrysler Capital Corp.*, 697 F. Supp. 794.

72. See *supra* notes 67-70 and accompanying text.

73. *V'soske v. Barwick*, 404 F.2d 495 (2d Cir. 1968)(Court found that correspondance between prospective buyer and seller of business created a binding contract despite disagreement over the term "audited net worth."); *Pyle v. Wolf Corp.*, 354 F. Supp. 346 (D. Or. 1972)(Court found binding agreement where the parties agreed to an oral settlement with a discussion of a written agreement).

74. *R.G. Group, Inc.*, 751 F.2d at 69 (Despite negotiation and a handshake deal, the court found the parties only intended to be bound by a written agreement.); *Reprosystem, B.V.*, 727 F.2d at 257 (Court found no intention to be bound before the formal contract even though the parties made an agreement in principle.); *Winston*, 777 F.2d at 78 (Court found no binding agreement although four drafts of an agreement were passed between the parties and funds relating to the agreement were passed in escrow.); *Chrysler*, 697 F. Supp. at 794 (Despite Chrysler depositing funds with Southeast pending negotiation of the commitment letter, the court found no binding agreement. However, the court admonished Southeast for abusing its relationship with Chrysler).

While all of the noted cases utilized the four-factor analysis, each case was dependent on its own facts and on the parties' intentions. Therefore, although the courts employed uniform guidelines, the ultimate resolution rested on the unique circumstances surrounding each case. See *supra* notes 67-70 and accompanying text.

75. *Teachers Ins. & Annuity Ass'n v. Butler*, 626 F. Supp. 1229, 1232 (S.D.N.Y. 1986); *Teachers Ins. and Annuity Ass'n*, 670 F. Supp. at 498; Knapp, *supra* note 36, at 676.

76. *Teachers Ins. and Annuity Ass'n*, 670 F. Supp. at 497. For instance, usual and customary terms in the lending business are "representations and warranties, closing conditions, other covenants, events of default and remedies, and requirements for the delivery of financial statements . . ." *Id.* at 496. The U.C.C. additionally takes the position that when the parties to a transaction leave out terms of price, delivery, payment terms, or quantity, the gaps are filled in one of four ways. J. WHITE AND R. SUMMERS, UNIFORM COMMERCIAL CODE § 3-3 (3d ed. 1988). The open terms can be supplied by examining the prior course of dealing between the parties (U.C.C. § 1-205(1)), by examining the custom in the industry (U.C.C. § 1-205(2)), or by examining the course of performance (U.C.C. § 2-208(1)). The U.C.C. provides the gap-fillers for terms

though it might seem a binding agreement could not result where there are open terms, that is not necessarily the case.⁷⁷ The "parties can bind themselves to a concededly incomplete agreement in the sense that both accept a mutual commitment to negotiate in good faith."⁷⁸ The good faith negotiation should result in a final agreement within the scope of the preliminary agreement.⁷⁹ "Each party actually regards himself as not completely bound, but rather committed to the deal and bound to the extent actual agreement is reached."⁸⁰

The good faith contract case occurs when the parties have failed to achieve "contract" status only because they did not reach a bargain complete and final enough to be legally recognized and enforceable.⁸¹ However, the courts can look to the parties' intentions to enforce the precontractual agreement to negotiate in good faith even though the actual terms to the deal remain to be negotiated.⁸² In other words, "the

capable of being ascertained. J. WHITE AND R. SUMMERS, UNIFORM COMMERCIAL CODE § 3-3 (3d ed. 1988). Generally the U.C.C. sections look to what is commercially reasonable. U.C.C. § 2-308 (absence place of delivery); U.C.C. § 2-305 (open price); U.C.C. § 2-309 (absence of specific time for delivery).

The gap-fillers suggest that for the open terms that are usual to a contract in a particular business, the best method of supplying the terms is looking at the standard in that particular business. WHITE AND SUMMERS, *supra*, § 3-3. However, if the parties have not reached agreement on the usual terms nor the material terms, then the gap-fillers would not serve to hold the contract together. *Teachers Ins. and Annuity Ass'n*, 670 F. Supp. at 497. White and Summers note that freedom of contract is the rule rather than the exception, and where the U.C.C. is silent, common law principles under § 1-103 apply. Therefore, if the material terms are not the usual terms of the industry or business, then they are not capable of being supplied by the gap-fillers. Thus the contract is incomplete and unenforceable. WHITE AND SUMMERS, *supra*, at 19.

77. See *supra* note 74.

78. *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 498.

79. *Id.* at 497. See also *Candid Prods., Inc. v. International Skating Union*, 530 F. Supp. 1330, 1333-34 (S.D.N.Y. 1982).

80. Knapp, *supra* note 36, at 681. A duty to negotiate in good faith does not require an automatic duty to approve the final deal. *A/S Apothekernes Laboratorium v. I.M.C. Chem.*, 873 F.2d 155, 159 (7th Cir. 1989). A party's rights under an agreement to negotiate in good faith consist of demanding that his counterparty negotiate the open terms in good faith with the ultimate goal of reaching a final contract. *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 498. The good faith "obligation does not guarantee that the final contract will be concluded as good faith differences in the negotiation of open issues may prevent reaching a final contract." *Id.*

81. Knapp, *supra* note 36, at 676.

82. *Channel Home Centers, Grace Retail v. Grossman*, 795 F.2d 291 (3d Cir. 1986). The court determined the parties' intentions by examining the letter of intent and the circumstances surrounding the letter. Finding that the letter of intent, signed by both parties, induced the tenant to proceed with leasing the store, the court further noted that the letter provided that the lessor would take the store off of the rental market and negotiate the lease until finalized. Through such language, the court held lessor's inducement to be an unequivocal promise, thereby imposing a duty to negotiate the lease in good faith. *Id.* at 298-99. Many jurisdictions which have considered

parties are bound to try in good faith to reach some agreement and not to withdraw from the proposed agreement for any reason other than the eventual failure to reach such agreement."⁸³

In determining whether the parties intended to be bound by an agreement to negotiate in good faith, the courts look to:⁸⁴ (1) the language of the agreement; (2) the context of the negotiations; (3) the existence of open terms; (4) partial performance; and (5) the necessity of putting the agreement in final form, which would be indicated by examining the customary form of such transactions.⁸⁵

Obligating parties to negotiate in good faith prevents one party from renouncing the deal, halting negotiations, or insisting on terms that do not conform to the preliminary agreement.⁸⁶ For instance, in *Teachers*, Tribune was found to have breached a preliminary agreement to bargain in good faith by insisting on offset accounting as a precondition to the loan.⁸⁷ Teachers presented evidence that Tribune's insistence on the additional condition was motivated by changing market conditions (lower interest rates) which made the initial deal unfavorable.⁸⁸

In some instances, the scope of the obligation to bargain in good faith can be as simple as negotiating in good faith until there is disagreement.⁸⁹ The duty to negotiate in good faith does not confer an automatic duty to approve the final deal.⁹⁰ In fact, there is no guarantee that even with the parties' good faith efforts to negotiate a final contract will result.⁹¹

the issue of whether an agreement to negotiate in good faith meets the test of enforceability have held that such an agreement, otherwise meeting the requirements of a contract, is an enforceable contract. *E.g.*, *Thompson v. Liquichema*, 481 F. Supp. 365, 366 (E.D.N.Y. 1979); *Reprosystem, B.V.*, 727 F.2d at 264; *Arnold Palmer Golf Co. v. Fuqua Indus.*, 541 F.2d 584 (6th Cir. 1976); *Itek Corp. v. Chicago Aerial Indus., Inc.*, 248 A.2d 625 (Del. 1968).

83. Knapp, *supra* note 36, at 681.

84. *Arcadian Phosphates, Inc. v. Arcadian Corp.*, 884 F.2d 69, 72 (2d Cir. 1989); *A/S Apothekernes Laboratorium*, 873 F.2d 155; *Itek Corp. v. Chicago Aerial Indus., Inc.*, 248 A.2d 625 (Del. 1968).

85. *Arcadian Phosphates, Inc.*, 884 F.2d 69; *Itek Corp.*, 248 A.2d at 629. In *Itek* the court held that to make the determination of whether an agreement to negotiate in good faith was in fact made, the trier of fact must look to "the circumstances surrounding the negotiations and the actions of the principals at the time and subsequent to the formation of such agreement." *Id.*

86. *A/S Apothekernes Laboratorium*, 873 F.2d at 158.

87. *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 496.

88. *Id.* at 501.

89. See *supra* note 80 and accompanying text.

90. See *supra* note 80 and accompanying text.

91. *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 491.

Many courts which have faced the issue of enforcing an agreement to negotiate in good faith have had some guidance into the parties' intentions via a "letter of intent."⁹² Often a letter of intent or the commitment letter has been dispositive of the case. However, such letters are not necessarily controlling.⁹³

In analyzing the binding quality of the good faith agreement, the courts place just as much importance on the facts of a particular situation as they do in the formal contract contemplated agreements.⁹⁴ The preliminary agreement to negotiate in good faith can be distinguished from the formal contract contemplated. The formal contract contemplated binds both parties to their ultimate contractual objective despite the fact that the agreement will be memorialized at a later date.⁹⁵ In contrast, the good faith agreement commits the parties to negotiate the

92. See *supra* note 67 and accompanying text. See *infra* note 93 and accompanying text.

93. *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 497. *Goodstein Constr. Corp. v. City of New York*, 502 N.Y.S. 2d 994, 494 N.E. 2d 99 (1986) (The court found that designation agreements which selected plaintiff to exclusively negotiate the terms and conditions of a land disposition agreement placed a duty on defendant to cooperate with plaintiff in negotiating the agreement for the eventual submission and approval of the agreement by the Board of Estimate.); *Itex Corp. v. Chicago Aerial Indus., Inc.*, 248 A.2d 625 (Del. 1968) (The court found a binding agreement to negotiate in good faith where the parties' exchange of letters in reference to a stock distribution plan obligated the parties to make every reasonable effort to agree on a formal contract.); *Channel Home Centers, Grace Retail v. Grossman*, 795 F.2d 291 (3rd Cir. 1986) (The court found a letter of intent between the parties obligated the parties to negotiate in good faith. The letter of intent stated that the lessor would take his store off the market and only negotiate the leasing transaction to completion with lessee.); *Thompson v. Liquichimica of Am., Inc.*, 481 F. Supp. 365 (S.D.N.Y. 1979) (The court found a binding agreement to negotiate in good faith where a letter signed by both parties' representatives obligated the parties to use their best efforts to reach an agreement to sell Liquichemica of America, Inc. to Thompson. The parties bound themselves in consideration for Thompson's temporary waiver of rights under an earlier contract.); *Runnemed Owners, Inc. v. Crest Mortgage Corp.*, 861 F.2d 1053 (7th Cir. 1988) (The court found that a qualified letter of commitment which outlined the terms of a proposed loan only bound defendant to consider lending plaintiff money. The letter was not an unqualified promise that consideration would lead to the desired financial help.); *Arcadian Phosphates, Inc. v. Arcadian Corp.*, 884 F.2d 69 (2d Cir. 1989) (The court held a memorandum between the parties did not amount to a binding agreement due to the fact that Arcadian Corporation, by the language of the letter, could not have believed itself bound to any agreement. The memo outlined the purchase price, timing and amounts of payments, fixed assets to be purchased, and a closing date. The memo further outlined a framework of negotiations for the purchasing of Arcadian's finished product inventory. However, the memo was vague on other terms such as how the transaction was to be financed, inventory transfer, charges for SG & A expenses and insurance coverage.); *Feldman v. Allegheny Int'l, Inc.*, 850 F.2d 1217 (7th Cir. 1988) (The court found that express language in the letter of intent negated any inference that the letter was a binding agreement. Instead, the express language stated the obligations and rights of the parties should be set forth in the definitive agreement executed by the parties.).

94. See *supra* note 93 and accompanying text.

95. See *supra* note 93 and accompanying text.

open terms in good faith in an effort to reach the contractual objectives stated in the framework of the preliminary agreements.⁹⁶ In both types of agreements the courts attempt to enforce parties' intentions through a detailed examination of the unique facts of the case.⁹⁷

In *Shearson Lehman CMO, Inc. v. TCF Banking and Savings* the court analyzed the agreement between the Shearson vice-president and TCF's representative as a formal contract contemplated agreement.⁹⁸ Therefore, the court utilized the four-factor analysis to examine the intent of the parties. The first factor considered was whether the parties expressed an intent to be bound only by written agreement.⁹⁹ Shearson asserted that no such intention was expressed between the parties. The court rejected Shearson's contention, noting that a mutual intent not to be bound except by writing is conclusively established when, during negotiations, neither party objects to provisions in the drafts indicating that the agreement will be valid and binding "when executed and delivered."¹⁰⁰ The court found that neither party took exception to a similar clause in the draft purchase agreement.¹⁰¹ The draft stated that if TCF agreed with the provisions in the draft, it should sign a counterpart and return it to Shearson "whereupon the Agreement [would] become a binding agreement."¹⁰² Therefore, the court found the parties intended to bind themselves to a written agreement only.¹⁰³

The second factor in the analysis concerned partial performance and acceptance of partial performance.¹⁰⁴ Shearson contended that partial performance was evidenced by purchasing the securities to be used in the transaction and by delivering to TCF the proposed tombstone which was returned by TCF with suggested revisions and incorporated

96. Knapp, *supra* note 36, at 680. The framework of an obligation could be established through the terms of a letter of intent or through a commitment letter. *A/S Apotekernes Laboratorium v. I.M.C. Chem.*, 873 F.2d 155, 159 (7th Cir. 1989).

97. See *supra* note 93 and accompanying text.

98. *Shearson Lehman CMO, Inc. v. TCF Banking & Sav.*, 710 F. Supp. 67 (S.D.N.Y. 1989). In other words, the court had to determine whether the parties intended to be bound by the oral agreement with a formalization of that agreement being incidental to the transaction. *Id.* at 70.

99. *Id.* See *supra* note 66.

100. 710 F. Supp. at 70 (citing *R.G. Group, Inc.*, 751 F.2d at 75).

101. *Id.* at 70-71.

102. *Id.* at 71.

103. *Id.*

104. *Id.* To establish partial performance, Shearson needed to show it conferred something of value on TCF which TCF accepted. *Id.*

into the final draft.¹⁰⁵ The court found that Shearson's act of purchasing securities did not confer a benefit on TCF, but was merely a preparatory act, insufficient to constitute partial performance.¹⁰⁶ Even though passing the document back and forth costs money for the preparation and revisions which benefitted both parties, the essential character of the act was preparatory.¹⁰⁷

The third factor considered was whether all of the terms were agreed upon, leaving nothing further to negotiate.¹⁰⁸ The facts of the deal indicated that TCF agreed to buy a certain quantity of securities at a stated price, along with specified interest and collateral.¹⁰⁹ However, following a review of the draft private placement agreement, TCF became concerned about the deal's tax and accounting problems.¹¹⁰ In fact, TCF's tax attorneys requested Shearson's attorneys to issue an opinion stating that the Series G CMO residuals were void of certain tax problems.¹¹¹ When Shearson's attorneys issued the opinion, TCF's counsel interpreted the opinion to say just the opposite. Therefore, Shearson was clearly on notice that these problems had to be resolved before TCF would agree to purchase the securities.¹¹²

As a result, terms that both parties understood as crucial to the agreement were still being negotiated and it was clear there had been no "meeting of the minds."¹¹³ Even though some terms had been agreed upon, there still was no agreement on *all* the terms to which agreement was anticipated. Therefore, there was no binding agreement.¹¹⁴

The final factor the court considered was whether this was the sort of agreement that is usually written.¹¹⁵ Shearson asserted that in the securities industry, the custom was to conclude deals orally rather than in writing, and that TCF itself thought it was bound by the oral agree-

105. *Id.* at 71.

106. *Id.* The preparatory act in *Shearson* consisted of buying the securities and sending the tombstone which was only evidence of preparation of the deal—not a part of the deal itself. *Id.* Additionally, the act of drafting and marking the tombstone was no more partial performance than TCF's acceptance of Shearson's long distance phone calls during negotiations. *Id.*

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.* at 72.

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.*

ment.¹¹⁶ In addressing this issue, courts often focus on the complexity of the proposed transaction to determine whether it would be unusual for parties to rely on an oral agreement.¹¹⁷

Even though the securities industry “tends to be an oral business,”¹¹⁸ the evidence indicated that each CMO is a fundamentally unique transaction and that trading CMO residuals is more complex than trading the CMO bonds themselves.¹¹⁹ Therefore, trading CMO residuals is a highly complex transaction—much more complex than trading in the secondary market.¹²⁰ Moreover, the transaction was worth about \$21 million. The court reasoned that the requirement that the agreement be in writing should not be surprising.¹²¹

Shearson offered evidence that TCF also was under the impression that securities were traded orally. The evidence consisted of a meeting of the TCF Asset Liability Committee held specifically to discuss the purchase of the Series G CMO residuals. In this meeting TCF referred to its current position in the purchase as “committed.”¹²² Yet when the minutes of the meeting were read as a whole, it was clear that the accounting, legal, and investment departments were expected to review the purchase before any final decision was made.¹²³ The term “committed” indicated an ongoing intent to purchase which was subject to change rather than reflecting a completed transaction.¹²⁴

After analyzing the four factors used to determine whether a contract existed between the parties, the court found that the parties did not intend contractual obligations until a signed agreement came into existence. Therefore, there was no binding contract between Shearson and TCF.¹²⁵

In contrast, the court in *Teachers* found the agreement between Tribune and Teachers to be a binding agreement to negotiate in good faith.¹²⁶ In utilizing the four-factor analysis, the court first considered whether the parties expressed an intent to be bound only by written

116. *Id.*

117. *Id.* See *supra* note 70 and accompanying text.

118. *Shearson, Lehman CMO, Inc.*, 710 F. Supp. at 72. The affidavit of Stanley McHaffy suggested that the securities industry is an “oral business.” *Id.*

119. *Id.*

120. *Id.*

121. *Id.* at 73.

122. *Id.* at 72.

123. *Id.*

124. *Id.* at 73.

125. *Id.*

126. *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 499.

agreement.¹²⁷ The court held that language such as "subject to approval" did not mean the agreement was not binding until such approval.¹²⁸

The agreement contained express language evidencing an intent to create a mutually binding agreement. This language did not leave either party free to walk away from the deal.¹²⁹ By examining the language in the context of the entire agreement and the parties' intentions in accordance with the negotiations, the court concluded the parties intended to be bound by an agreement to resolve the open terms in good faith.¹³⁰

The second factor the court considered was partial performance. Although Teachers' loan commitment to Tribune was informal, the commitment involved a budgeting of funds to be lent out. This reduced Teachers' net amount considered to be available for new loans.¹³¹ The allocation of loan commitment reserved the funds for Tribune's loan and prevented Teachers from taking advantage of other opportunities to loan the money.¹³² However, the court also noted that "[A] party's partial performance does not necessarily indicate a belief that the other side is bound."¹³³ "A party may make some partial performance only to further the chance of closing a transaction it considers

127. *Id.*

128. *Id.* at 500. The court noted that the term "subject to approval" is to be considered in the context of the agreement. The parties recognized that their deal would require further documentation and negotiation of the open terms. Therefore, the "subject to approval" reservation made it clear that a party or its board can insist on appropriate documentation and negotiation for protections which are customary for such transactions. *Id.*

129. *Id.* When Tribune signed the commitment letter, it used words such as "accepted and agreed to." Additionally, Tribune's letter of acceptance began with "attached is an executed copy of the commitment letter . . . for \$76 million loan." *Id.* at 499. The exchange of letters which constituted the commitment was full of terms associated with a binding agreement. For example, one letter required that if Tribune was going to accept the conditions of the letter, a duly authorized officer should execute a copy of the letter and return one counterpart. Other language indicated that once Teachers received the counterpart, the agreement would be binding. *Id.*

130. *Id.* The court examined the language in the exchange of letters and the commitment letter to determine if the parties expressed an intent to be bound by an agreement. *Id.* In addition, the court found that the parties made a binding agreement on the stated terms, and Teachers' reservation of right of approval by its board was simply a recognition that various issues remained open which would require documentation and approval. *Id.* at 500. Therefore, by combining the language of the agreements with the parties' intentions to be bound, the court found a binding agreement to negotiate in good faith. *Id.* at 499-500.

131. *Id.* at 502.

132. *Id.*

133. *Id.*

advantageous."¹³⁴

The third factor the court examined concerned the open terms.¹³⁵ Although some of the terms of the agreement were open, the term sheet attached to the commitment letter covered the major economic terms.¹³⁶ The agreement was enforceable even though minor terms remained to be settled.¹³⁷ Teachers, in keeping with its contractual obligations, asked Tribune to sit down and negotiate in good faith on the open points.¹³⁸

Finally, the court looked at whether the transaction at issue was one which is usually committed to writing.¹³⁹ The standard the court applied is whether it is customary in the relevant business community to give binding force to the type of preliminary agreement at issue.¹⁴⁰ Expert testimony established that it is within recognized practices of the financial community to accept preliminary commitments of this type as binding.¹⁴¹ Tribune failed to establish that the commitment between Teachers and itself was outside recognized practices.¹⁴²

Based on the four-factor test, the court in *Teachers* found the parties had an agreement to negotiate in good faith.¹⁴³ Ultimately, the determining factor was that the open terms were easily negotiated¹⁴⁴ and immaterial to the overall agreement.¹⁴⁵ Consequently, the court held that based on a good faith obligation, Tribune could not walk away

134. *Id.*

135. *Id.* at 501.

136. *Id.* The two page term sheet attached to the commitment letter covered the important economic terms of the loan. See *supra* note 14 and accompanying text.

137. *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 502. The court stated that the commitment letter contained the significant economic terms, and the fact that there was no mention of the conventional, customary mortgage terms did not render the contract unenforceable. *Id.*

138. *Id.*

139. *Id.* at 503.

140. *Id.*

141. *Id.*

142. *Id.* Some preliminary commitments are not binding. Tribune could have established that the agreement was binding on one side only. For example, if Tribune paid a commitment fee to bind Teachers, the agreement may have been in the nature of an option to Tribune to decide by a specified date whether to go ahead with the transaction. In such a case, Teachers would have paid for its one-sided commitment. These types of preliminary agreements are seen as mere letters of intent which would leave both sides free to abandon the transaction. *Id.*

143. *Id.* at 508.

144. *Id.* at 501.

145. The two page term sheet to the mortgage sufficiently specified the material terms which made the commitment letter binding and enforceable. *Id.* at 502. See *supra* note 14 and accompanying text.

from the deal without liability to Teachers.¹⁴⁶

Preliminary agreements, which were nonexistent under traditional contract law principles, have evolved to comport with modern business transactions. Until fairly recently, the usual type of preliminary agreements the courts analyzed constituted a narrowly defined category.¹⁴⁷ For example, the courts faced problems with agreements between contractors and subcontractors, or insurance companies' "binders" to the insured.¹⁴⁸ Currently, however, preliminary agreements constitute a usual course of conduct between businessmen.¹⁴⁹ Many deals are negotiated orally; the parties negotiate a preliminary agreement on all the terms which they consider material, and leave the final negotiations and document drafting to their lawyers or accountants.¹⁵⁰ The reality of the transaction lies in the fact that the parties carried the deal as far as they could and then relied on their agents to complete the deal.¹⁵¹ Nevertheless, the principals may consider themselves bound by the framework of their agreement.¹⁵²

The *Shearson* and *Teachers* decisions reveal a tendency for courts to hold preliminary agreements binding, despite the fact that all the essential terms are not completely resolved. The courts will either bind the parties to a preliminary agreement based on their intent to be bound (despite lack of formal agreement), or the courts will bind the parties to an agreement to negotiate open terms in good faith.¹⁵³ However, remaining open terms must be susceptible to negotiation and resolution within a recognizable range of normal business practices before the courts will impose such a duty.¹⁵⁴

There are two aspects of modern business which have prompted increased reliance on precontractual agreements.¹⁵⁵ The first is the fact that commercial transactions are often consummated between parties of different countries with significantly different cultural and legal sys-

146. *Id.* at 508.

147. 1 A. CORBIN ON CONTRACTS § 30 (1963).

148. *Id.*

149. Knapp, *supra* note 36, at 679.

150. Knapp, *supra* note 36, at 679.

151. Knapp, *supra* note 36, at 679.

152. Knapp, *supra* note 36, at 679.

153. *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 498.

154. *Id.* at 497. Examples of terms which would fall within the recognizable range would be terms of notice, default, representations and warranties, various grace periods, and closing conditions. *Id.* at 496.

155. Lake, *supra* note 51, at 332. See Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963).

tems.¹⁵⁶ Because of the unfamiliarity with a foreign system, the parties may be more comfortable reducing the goals of the deal at a relatively early stage of the negotiations.¹⁵⁷ Secondly, modern business transactions are becoming noticeably more complex and involve contracts containing an extensive set of documents.¹⁵⁸ Reviewing and red-lining the documents, while resolving numerous details, is a lengthy process. Moreover, the negotiation often involves multiple parties.¹⁵⁹ Therefore, precontractual agreements with binding moral, if not legal, force would aid in bringing order to complex transactions.¹⁶⁰

"Legal recognition of preliminary binding commitments serves a valuable function in the marketplace, especially with standardized transactions such as loans."¹⁶¹ Absent such legal recognition, parties would spend outrageous amounts of time, money, and resources negotiating every detail of the final contract. Expending time and money before knowing whether, under the eyes of the law, an enforceable agreement existed could be risky.¹⁶² Yet a party not wishing to be bound during the preliminary stage can protect itself from legal enforcement by objecting to language which indicates a "firm commitment" or "binding agreement."¹⁶³ Therefore, the significance of *Teachers* and *Shearson* lies in the fact that courts are slowly making a transition toward enforcing the *reality* of the transaction rather than the *form* of the transaction.

While the *Shearson* court utilized the four-factor analysis test, the court found no binding agreement. This indicates that even though there is a willingness to be flexible and examine the realities of the transaction, the court is still hesitant to enforce an agreement not in accord with the parties' intentions. In balancing the freedom to negoti-

156. Lake, *supra* note 51, at 332.

157. Lake, *supra* note 51, at 332.

158. Lake, *supra* note 51, at 332. Legal arrangements necessary for large transactions such as the sale and installation of high technology equipment and infrastructure facilities in less-developed countries, turnkey projects for the construction of manufacturing facilities, arrangements for exploration of natural resources, large-scale corporate acquisitions and mergers are necessarily quite complicated. Fontaine, *Les lettres d'intention dans la negociation des contracts internationaux*, 3 DROIT ET PRACTIQUE DU COMMERCE INTERNATIONAL 73, 76 (1977).

159. Lake, *supra* note 51, at 332.

160. Fontaine, *supra* note 158.

161. *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 499. For instance, legal recognition allows "borrowers and lenders to make plans in reliance upon their preliminary agreements and present market conditions." *Id.*

162. *Id.*

163. *Id.*

ate and enforcement of preliminary agreements to be bound, the court gave a clear signal that the freedom to negotiate is deeply embedded in the traditional law of contracts. Therefore, if there is any deviation from traditional standards, the party attempting to establish the existence of a binding preliminary agreement must clearly demonstrate both parties' intentions to be bound.

The result reached in *Shearson* was fair in that Shearson was aware TCF would not accept a deal with unfavorable tax and accounting consequences. Therefore, the court reached a traditional result in the case despite the modern analysis. The ultimate factor which swayed the court was that the terms remaining to be negotiated were of material significance. The parties could not continue to negotiate and reach an agreed-upon result—the deal either had the problems or it did not. No amount of negotiation could change the end result.¹⁶⁴ Due to the open material terms and the parties' intentions, the court could not hold the parties bound to a formal agreement contemplated. Neither could the court hold the parties to an agreement to negotiate in good faith, since there was nothing left to negotiate.¹⁶⁵

In contrast, the court in *Teachers* reached a "modern result" using the modern analysis. The court examined the reality of the transaction and held that the open terms were not of material significance and were subject to negotiation.¹⁶⁶ The court refused to follow the traditional rule that no agreement existed unless there was a "meeting of the minds" on *all* essential terms.¹⁶⁷

In rejecting the traditional rules, the court demonstrated a willingness to employ legal realism.¹⁶⁸ The terms remaining to be negotiated were standard terms for a lending agreement rather than material terms such as amount to be borrowed or method of payment.¹⁶⁹ The court was unwilling to allow Tribune to walk away from the transaction by hiding under the traditional umbrella of "meeting of the minds."¹⁷⁰ Additionally, in holding that the binding agreement between the parties constituted good faith negotiations, the court furthered a policy of encouraging parties to work out their differences and ulti-

164. *Shearson Lehman CMO, Inc.*, 710 F. Supp. at 72.

165. *Id.*

166. *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 501.

167. *Id.*

168. See *supra* note 48 and accompanying text.

169. *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 508. See *supra* notes 136-37 and accompanying text.

170. *Teachers Ins. & Annuity Ass'n*, 670 F. Supp. at 508.

mately reach an agreement as opposed to allowing the parties to close down a deal based on a minor issue.

There is no concrete general standard to determine whether a party intends to be bound by a preliminary agreement. The analysis is very fact intensive. Reconciling the results in *Shearson* and *Teachers* requires nothing more than examining the intentions of the parties and the terms that remain to be negotiated. The similiarity of the cases lies in the fact that both courts demonstrated a trend toward legal realism.

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