Contract Law Update

Is an Executed Term Sheet a Binding Contract or an Unenforceable "Agreement to Agree"?

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Whether an executed term sheet detailing the terms of a loan represents a binding agreement to lend or merely an unenforceable "agreement to agree" was the subject of an important ruling handed down by the Appellate Division of the New York State Supreme Court in February 2010. In *Amcan Holdings, Inc. v. Canadian Imperial Bank of Commerce*, the court held that a financing term sheet expressly providing that binding terms will be established only upon the completion of definitive loan documentation does not create an enforceable agreement to lend.

In 2001, Amcan Holdings, Inc. ("Amcan"), approached Canadian Imperial Bank of Commerce ("CIBC") to obtain financing in the form of a revolving line of credit and a term loan for the purpose of acquiring another company and refinancing existing debt. The parties negotiated and later executed a "Summary of Terms and Conditions" outlining the proposed terms of the loans (the "term sheet"). The term sheet contained a highlighted box at the top of the first page stating that "[t]he Credit Facilities will only be established upon completion of definitive loan documentation, including a credit agreement . . . which will contain the terms and conditions set out in this Summary in addition to such other representations . . . and other terms and conditions . . . as CIBC may reasonably require."

The executed term sheet contained specific details regarding a number of items, including, among other things, the identity of the borrowers, the amount of funding to be provided under each credit line, amortization and interest rates, fees, security, a proposed closing date, and

definitions of key terms. Under the subheading "Conditions Precedent" in the term sheet were set forth terms "[u]sual and customary for transactions of this type," such as "Initial Funding" and the "Execution and delivery of an acceptable formal loan agreement and security . . . documentation, which embodies the terms and conditions contained in this Summary."

The term sheet also provided for payment of a $500,000 fee to CIBC, with $50,000 payable upon acceptance of the first draft summary, $150,000 payable upon acceptance of the executed term sheet, and $300,000 payable upon the closing of the financing transaction. Amcan paid the first two installments, which were not refunded by CIBC when the deal later terminated. The term sheet did not expressly provide that CIBC was obligated to negotiate in good faith to enter into definitive loan documentation.

Prior to the execution of the final credit agreement and other loan documentation, CIBC discovered that Amcan had failed to disclose that it had been enjoined from pledging certain stock as collateral for the loans—a condition precedent to closing the transaction. CIBC also alleged that Amcan's principal failed to disclose that he had been held in contempt for violating the injunction on two separate occasions. CIBC broke off negotiations and the deal was never consummated.

Amcan sued CIBC six years later, asserting causes of action for breach of contract based on the bank's failure to close the loan, breach of the obligation of good faith and fair dealing, and fraud. CIBC moved to dismiss, arguing that the executed term sheet was not a binding agreement but a mere "agreement to agree" and that it had not acted arbitrarily in breaking off negotiations after

discovering Amcan's disclosure failures. The New York State Supreme Court denied the motion to dismiss the breach-of-contract claim, ruling that the circumstances presented at what was then a preliminary stage of the proceedings did not permit a determination as to whether the term sheet was a binding agreement or merely an agreement to agree. The court, however, granted the lender's dismissal motion with respect to the remaining claims.

The Appellate Division affirmed the ruling on appeal, with certain important modifications. Addressing whether the term sheet represented an enforceable contract, the court focused on the parties' intent to be bound (*i.e.*, whether there was a "meeting of the minds" regarding the material terms of the transaction). It found that no such intent existed:

> Here, both the [draft term sheet and the term sheet] clearly state the credit facilities "will only be established upon completion of definitive loan documentation," which would contain not only the terms and conditions in those documents but also such "other terms and conditions . . . as CIBC may reasonably require." Although the [term sheet] was detailed in its terms, it was clearly dependent on a future definitive agreement, including a credit agreement. At no point did the parties explicitly state that they intended to be bound by the [term sheet] pending the final Credit Agreement, nor did they waive the finalization of such agreement . . . .
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> The parties disagree on whether the [draft term sheet and the term sheet] fall into a Type I (fully negotiated) or Type II (terms still to be negotiated) preliminary agreement, commonly used in federal cases addressing the issue of whether a particular document is an enforceable agreement or merely an agreement to agree . . . . However, our Court of Appeals recently rejected the Federal Type I/Type II classifications as too rigid, holding that in determining whether the document in a given case is an enforceable contract or an agreement to agree, the question should be asked in terms of "whether the agreement contemplated the negotiation of later agreements and if the consummation of those agreements was a precondition to a party's performance" . . . .
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> Here, the [term sheet] made a number of references to future definitive documentation, starting with the box on page one of the [term sheet]. The fact that the [term sheet] was extensive and contained specific information regarding many of the terms to be contained in the ultimate loan documents and credit agreements

does not change the fact that defendants clearly expressed an intent not to be bound until those documents were actually executed.

Amcan Holdings, Inc. v. Canadian Imperial Bank of Commerce, 894 N.Y.S.2d 47 (N.Y. App. Div. 2010).