

Report From Counsel

Insights and Developments in the Law

Winter 2011/2012

Real Estate Letters of Intent

A letter of intent (LOI) reduces to writing a preliminary understanding of parties who intend to enter into a contract, including contracts to purchase real property. The concept falls somewhere on the continuum between the first informal talk about a possible deal and a binding written agreement covering all of the essential terms. By its

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nature, an LOI does not bind the parties to the transaction, raising the question as to how it can still be useful. An LOI is evidence of some commitment, albeit more moral than legal, to the deal. A potential buyer with an LOI in hand has an edge over others who may have an eye on the property. Having laid a foundation on which a deal could be built, the buyer and the seller can feel more comfortable about putting in the effort, energy, and money that may be necessary to actually close the deal.

LOIs have potential drawbacks and should not be entered into without advice of counsel. First, if an LOI is produced only after extensive propos-

als and counter-proposals, or if it becomes stuffed with details you would normally expect to find in the fine print of a contract, it may be more trouble than a nonbinding document is worth. All of that work is better saved for the “main event.”

Second, while it may be appropriate and even desirable to describe the key terms of the subsequent contract in the LOI, it must be made very clear that the terms are not yet binding. In fact, an

LOI should state generally that the parties do not intend to be legally bound to consummate any transaction until they have signed and delivered a written agreement in which they agree to be bound. It helps in this regard to avoid using boilerplate contract terms like “agree,” “offer,” and “accept” in an LOI. Language to the effect that an agreement is subject to formal docu-

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Tomato: Fruit or Veggie?

The very identity of the tomato is and has for a long time been a point of contention. On the one hand, botanical purists point out that the tomato should be considered a fruit, given that it is the fruit of a vine. On the other hand, as part of our diets, the tomato “acts” like a vegetable.

Over a century ago, no less than the U.S. Supreme Court took up the subject, ruling in a short opinion that the tomato should be treated as a vegetable. The issue arose over a protest mounted in court by importers of tomatoes from the West Indies against a tariff that had been imposed on the tomatoes. The tariff could be imposed on vegetables but not on fruits.

The Supreme Court case boiled down to competing experts for both sides, as well as competing dictionary definitions. In the end, since the terms “vegetable” and “fruit” were found not to have any specialized meanings in the context of trade and commerce, the Court decided to treat tomatoes as most people did at the time when they ate them, that is, as vegetables.

In short, the Court determined that whichever way the tomato may have been characterized by botanists, it usually was used and treated as part of the meal itself (or “repart,” in the Court’s words) and not, like most fruits, as a dessert. Thus, the plaintiff importers could not avoid the challenged tariff.

Natural Gas Exploration Not Allowed in the Suburbs

An oil and gas company was enthusiastic enough about the prospects for finding and bringing up natural gas on a particular piece of property that in addition to securing a lease from the property owner for exploration and drilling, it agreed to pay him a signing bonus of nearly \$100,000. As you read this, you are likely to be picturing a scene from the Great Plains or a prairie in Texas, but think again. The property subject to the lease was in a residential subdivision in the northeast, complete with an array of typical restrictive covenants and a property owners association (POA) eager to enforce them.

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To be accurate, the parcels in the subdivision were on the large side, ranging from 2 to 100 acres, and the leased parcel was about 66 acres. Still, it is a head-scratcher to comprehend how the company, which by all accounts was sophisticated and even knew about the restrictive covenants from the outset, thought it could actually turn part of a leafy subdivision into a site for extracting natural gas. The company's explanation was that the restrictive covenants were loosely worded enough to allow for natural gas exploration. That explanation carried no weight with the trial court, which ruled in favor of the POA that the lot could not be used for that activity.

It is true that restrictive covenants generally must be construed most strictly against those seeking to enforce them. But that principle does not allow the plain language in a document to be ignored. One of the subdivision cove-

nants said that properties in the subdivision could be used only for single-family homes or for agricultural and/or recreational use. No oil or gas exploration was contemplated in that covenant.

The other relevant covenant stated that there could be no commercial fishing enterprises, boat-launching facilities, or any other commercial uses. The oil and gas company apparently had pinned its hopes on a court's reading these covenants as prohibiting only fishing and boat-launching activities on the 70-acre lake in the subdivision, but the clear language about "any other commercial uses" would have to have been ignored to get that result. The court declined to do so.

To add insult to injury, the court also refused to allow the oil and gas company to recover the large signing bonus that it had paid to the subdivision resident. The bonus had been paid under the

lease, which described the bonus as non-refundable. And the lot owner, who also knew about the restrictive covenants, had included a disclaimer in the lease about what uses were restricted on his property. The bonus was subject to the company's "approval of title," and there was no dispute that a company representative responsible for approving leases had been aware of the covenants but forged ahead anyway.

In the end, the POA won in having the covenants enforced, and the lot owner was an even bigger winner, getting a handsome sum essentially for nothing, as his lot was not subjected to natural gas exploration. As for the oil and gas company, it learned an expensive lesson: If you are hoping to make your fortune with a gusher in suburbia, learn all you can about applicable restrictive covenants, heed them, and go elsewhere.

“Freeze” Your Credit to Help Prevent Identity Theft

By now, most people are familiar with the threat of identity theft and the uses to which the thieves might put your stolen identity. This includes using your personal information to charge goods and services on a new bogus credit card.

There are the usual preventive measures you can take, such as keeping personal information close to your vest, using passwords, and shredding financial documents you no longer need. You can also get regular credit reports from the three major credit bureaus—Equifax, Experian, and TransUnion—and/or sign up for a credit monitoring service. These latter actions certainly have some value, but they may only go so far as to help you discover that the “horse is already out

of the barn” rather than help you to prevent the theft in the first place.

Another theft prevention approach that may be less familiar to most consumers is the credit freeze (sometimes called a “security freeze”). Although the term sounds as if you are left out in the cold as far as your credit is concerned, when properly used it can give you the comfort of some additional financial security and leave would-be thieves out in the cold instead.

You can put into place a credit freeze by notifying the credit bureaus, providing certain personal information, and paying what should be a modest fee. When the freeze is in place, it stops all potential creditors from seeing your

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The IRS Is Here to Help

To help struggling taxpayers who owe back taxes, the Internal Revenue Service (IRS) recently unveiled a series of new steps to help people get a “fresh start,” to use the phrase invoked by the IRS Commissioner, with their tax liabilities. The general idea is to recognize the challenging economic environment the country faces while also keeping the tax revenue flowing in at acceptable levels. The focus is on changes to the tax lien system and other collection tools already used by the IRS that will make paying taxes a little easier on taxpayers.

Tax Lien Thresholds

The IRS will significantly increase the dollar thresholds for when liens are filed to a new dollar amount that will be in keeping with inflationary changes that have occurred since the number was last revised. Currently, liens are automatically filed at certain dollar levels for people with past-due balances.

A federal tax lien is no trivial matter. It gives the IRS a legal claim to a taxpayer’s property for the amount of an unpaid tax debt, and it can establish priority rights against certain other creditors. Since a tax lien can also adversely affect a taxpayer’s credit rating, taxpayers are well advised to arrange for the payment of taxes as quickly as possible.

Tax Lien Withdrawals

The IRS will make it easier for taxpayers to obtain lien withdrawals under certain circumstances, including the IRS’s determination that the lien filing was premature or that the taxpayer has agreed to an installment payment plan. To facilitate the withdrawal process, the IRS will also streamline its internal procedures to allow collection personnel to withdraw the liens.

Direct Debit Installment Agreements and Liens

The IRS is making other important changes to liens when taxpayers enter into a Direct Debit Installment Agreement (DDIA). For taxpayers with unpaid assessments of \$25,000 or less, the IRS will now allow lien withdrawals in a few different situations: for a taxpayer entering into a DDIA; for a taxpayer converting a regular Installment Agreement to a DDIA; for a taxpayer already on an existing DDIA, upon the taxpayer’s request; and for a taxpayer demonstrating after a probationary period that direct debit payments will be honored.

Installment Agreements and Small Businesses

The IRS has made streamlined Installment Agreements available to more small businesses by raising the dollar limit to allow more small businesses to participate. Small businesses with \$25,000 or less in unpaid taxes can participate. Previously, only small businesses with under \$10,000 in tax liabilities could participate. Small businesses will have 24 months to pay.

Small businesses with an unpaid assessment balance greater than \$25,000 may qualify for the streamlined Installment Agreement if they pay down the balance to \$25,000 or less. But small businesses will need to enroll in a DDIA in order to participate.

Offers in Compromise

The IRS is also expanding a new streamlined Offer in Compromise (OIC) program to cover a larger group of taxpayers who can use the help. Taxpayers with annual incomes of up to \$100,000 can participate. Participants must have a tax liability of less

than \$50,000, doubling the previous limit of \$25,000 or less.

An OIC is an agreement between a taxpayer and the IRS that settles the taxpayer’s tax liabilities for less than the full amount owed. As you might expect, it is something of a last resort. Generally, an OIC will not be agreed to by the IRS if the IRS believes, given the taxpayer’s income and assets, that the liability can be paid in full as a lump sum or through a payment agreement.

Freeze Your Credit

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credit report and credit score unless you decide to “thaw out” your credit with the credit bureaus by using a personal identification number. Since any potential creditor considering a thief’s application for credit will not be able to check the real consumer’s credit report or score while the freeze is on, the creditor will not be able to extend credit, and this prevents the new bogus account from being created.

Credit freezes are not a fail-safe wall of protection against identity theft, but they do give you another defense in the fight. They also do not entail significant inconvenience or cost. Even with a freeze in place, you can use any of your existing sources of credit. A credit freeze especially makes sense if you have no plans to apply for new credit any time soon. But even if you wish to do so, for another reasonable fee you can lift the freeze temporarily for up to 30 days, during which time credit checks can be made in the usual manner by your potential creditors.

Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects, but rather to provide insight into legal developments and issues. The reader should always consult with legal counsel before taking action on matters covered by this newsletter.

Yet Another Hazard on the Golf Course

Hazards to a golfer's health and safety that come most readily to mind involve swinging clubs and golf balls in flight, usually on unintended flight paths. But the sport also has other dangers lurking, including the garden variety slip and fall. When James, a golfer, sued a golf resort recently over such a mishap, his claim was dismissed, essentially because the particular risk at issue in his case should have been apparent to him and, as such, it was up to him to avoid it.

On an overcast and rainy day, James was playing golf with three friends at a private golf course. It began to drizzle early in the round, and by the 14th hole, the rain was coming down hard. Approaching the 15th hole, James and his friends discussed stopping play but decided to press on.

As James walked toward the green with one of his companions, they used stairs made of bricks and wooden railroad ties. James was familiar with the golf course, having played there on prior occasions. Although he had never before used the stairs leading to the 15th green, he had seen them.

After his friend walked down without incident, James followed and slipped on one of the first steps, breaking his ankle. At the time, it was raining and James was looking down, talking, and holding his putter in his right hand. Without incident, the other two in the foursome had taken an entirely different route on the grass, avoiding the steps.

James's lawsuit did not fail for lack of effort, in that he enlisted an expert witness to buttress his theory that the resort's negligence had caused his injury because the stairs had not been made slip resistant in wet conditions. The argument never got off the first tee, as it were, because the expert relied upon building code requirements per-

taining to making "floor surfaces" slip resistant and the federal court hearing the case ignored the entire line of reasoning as "irrelevant."

As the court saw it, it was obvious that such a building code requirement was never meant to apply to an outdoor golf course. For that matter, the stairs embedded in the ground at the 15th hole were not even part of a "building or structure" to which building codes apply.

Because of the court's dim view of the expert evidence offered, James was

left exposed to the resort's contention, with which the court readily agreed, that James could not blame his unfortunate slip and fall on the resort or anyone else. In legal parlance, James had "assumed the risk" of walking on the wet stairs. The risk was obvious, inherent in the activity, and not so serious as to justify placing a greater precautionary burden on the resort operating the course. The court noted that this legal principle "facilitates free and vigorous participation in athletic activities."

Letters of Intent

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mentation may be helpful, but by itself it may not rule out a conclusion that the parties intended to be bound. Similarly, while it may not settle the issue, calling the document a "letter of intent" implies a nonbinding expression in contemplation of a future contract.

In an LOI, the buyer and the seller may need to bind themselves to certain preliminary matters leading up to the contract, however, such as access to the property for inspections. In that case, it is essential to distinguish clearly between nonbinding and binding items in the LOI. Even when the language of the LOI is in good order, a party to the LOI should take care to avoid conduct or statements that are at odds with the LOI's preliminary nature. Otherwise, the other party may attempt to argue, in effect, that actions speak louder than even written words, and that both parties meant to be, and are, bound by everything in the LOI.

In a recent case, a court ruled that a "letter offer" sent by a developer and signed by the owner of undeveloped land was not a binding agreement. The factors that led to the decision are instructive. The language in the letter stating that it "will serve to set forth some of the parameters for an offer" suggested the setting of negotiating boundaries, rather than final terms. The letter expressly anticipated that a contract of purchase and sale would be executed later.

It was also significant that several key obligations and events concerning the expected sale, such as the beginning of an inspection period, were to be triggered only by the execution of a contract, not by the offer itself. Finally, the letter offer omitted some terms one would expect to find in a multimillion-dollar contract for the sale of property, such as a closing date, warranties, conveyance provisions, responsibility for taxes, and how the parties were to notify each other of contractually significant events.