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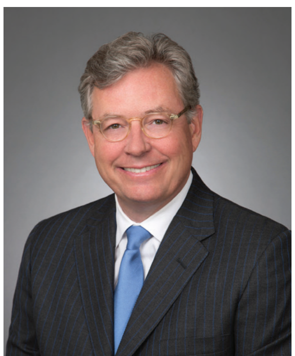
A cautionary tale of letters of intent in aircraft transactions



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Timothy Lynes, managing partner and Brett Seifarth, associate, at Katten Muchin Rosenman's Washington office, recalls Global BTG LLC v National Air Cargo, a case involving a breach of letter of intent for eight Boeing 747 Freighters.

Parties to aircraft purchase, lease and/or finance agreements many times rely on letters of intent (LOI) or term sheets to spell out the basic commercial terms of their transaction. With few exceptions, these parties do not consider the LOI to be a binding agreement in most respects; rather, these contracting tools are seen as agreements to agree.

However, in Global BTG LLC v National Air Cargo, the Ninth Circuit affirmed the trial court's award of $8 million for breach of contract after a jury found that the defendant, National Air Cargo, breached an alleged exclusive LOI to purchase and finance up to eight Boeing 747 reighters. The court held that the absence of an exclusivity provision in the LOI does not make the contract non-exclusive as a matter of law when there are material questions of fact presented by conflicting extrinsic evidence as to the parties' intent.

The court further held that the question of exclusivity was in the proper province of the jury and substantial evidence supported the jury's verdict that a contract existed and was breached by National. The outcome of this case should serve as a warning to all those who use LOI as a prelude to the conclusion of the actual transaction documentation.

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Global BTG LLC v National Air Cargo

In May 2010, National reached a preliminary agreement to purchase three Air France Boeing 747 aircraft for $120 million and signed a purchase agreement with Japan Airlines for five 747 aircraft for $192.5 million. National required financing to fund the purchase of these aircraft and needed to obtain financing quickly to meet the delivery dates in the aircraft purchase agreements. It engaged various aircraft financiers, including Global BTG, Citibank, Deutsche Bank and Goldman Sachs.

Global and National signed aLOI on 18 July 2010 to enter into a sale and leaseback transaction with Global as the lessor and National as the lessee. The LOI, which was governed by New York law, provided for specific terms for many issues, such as aircraft serial numbers, delivery condition of the aircraft, the lease term, the security deposit, transaction costs, confidentiality, governing law and conditions precedent. The LOI was conditional in many other respects, such as aircraft purchase price, rental rates, lease structure, purchase option, maintenance reserves and return conditions.

The LOI was silent as to terms of exclusivity between the parties. It did state, however, that the sale and lease of the aircraft was subject to the following conditions:

- Global's board of directors' approval;
- satisfactory inspection of the aircraft and records;
- satisfactory tax and legal opinions; and
- mutually satisfactory lease or financing documentation.

In addition, the parties agreed that Global would use its best efforts to deliver to National on or before 22 July 2010 (four days after the LOI was executed) a memorandum of understanding (MOU) from a qualified lender to provide financing to purchase the aircraft. Despite these conditions precedent, the LOI stated it was "intended as a binding agreement" and that National and Global would "work together in good faith to implement the provisions hereof, to complete the transactions and to negotiate, execute and deliver all necessary and appropriate leases and other agreements in form and substance consistent with industry standards in a timely manner".

On 23 July 2010, National's agent contacted Global to terminate the contractual relationship between the parties, citing National's need to secure financing for the Japan Airlines aircraft as soon as possible. In response, Global asserted that five business days is not a reasonable amount of time to obtain financing for these aircraft and expressed its desire to continue with the transaction, because it had already contacted 75 to 100 funding sources in the debt and capital markets to secure financing. Without moving forward with the transaction, such efforts could severely damage the reputation of both parties in the aviation industry, according to Global.

Global and National were not able to recover from the LOI dispute. National secured financing from Goldman Sachs for the three Air France 747s, but was not able to complete the transaction for the Japan Airlines aircraft. Global eventually sued for breach of contract and deceit, claiming that National breached an express agreement to sell and lease from Global the eight 747s and fraudulently induced Global to enter into the express agreement with material misrepresentations regarding exclusivity and the time period by which Global was to secure financing. National counterclaimed, asserting claims for intentional misrepresentation, negligent misrepresentation, breach of contract and promissory estoppel.

On cross motions for summary judgment, the United States District Court judge in California narrowed the triable issues by granting partial summary judgment to National on Global's claim that the LOI required National to enter into at least one operating lease and partial summary judgment to Global on the issue of its capacity to contract. Importantly, it found that the LOI was ambiguous as to the exclusivity issue, which would require the jury to hear extrinsic evidence, ultimately creating a material issue of fact to preclude judgment as a matter of law before trial.

Finding in favour of Global at trial that the agreement was exclusive by default, the jury ultimately awarded $8 million in damages to Global, which amounted to a broker fee of $1.9 million per aircraft or about $8 million.

On the limited issue on appeal, the Ninth Circuit concluded that the jury "saw and heard extensive evidence on why the LOI made no sense to Global without exclusivity". The jury stated that the agreement "concerned eight specific aircraft, and two different brokers could not purchase and lease back the same aircraft."

Lessons learned

There are several lessons to take from the case. First, the LOI was silent on exclusivity. The trial court's ruling on the ambiguous nature of the LOI regarding exclusivity was perhaps the most important part of the case. Without that ruling, Global would be hard pressed to present evidence of National's attempt to insert a provision that the LOI was to be non-exclusive and National's allegedly tacit approval of striking the provision in light of Global's fierce objection to such a provision. Global also was able to present expert testimony that letters of intent are intended to be exclusive across the aircraft finance industry, and that most deals are completed if they reach the term sheet stage.

It would be wise for the parties to reach an understanding on whether the LOI is to be exclusive and to indicate it in the LOI. Courts have held that under New York law, a preliminary agreement ordinarily does not create a binding contract; however, preliminary agreements can create binding obligations in certain circumstances.

There are five factors that the court considers when determining whether an agreement imposes a binding obligation to negotiate in good faith:

1. Whether the intent to be bound is revealed by the language of the agreement.
2. The context of the negotiations.
3. The existence of open terms.
4. Partial performance.
5. The necessity of putting the agreement in final form, as indicated by the customary form of such transactions.

Parties can provide certainty where a contract has express language regarding exclusivity.

The LOI also provided that it was intended to be a binding agreement between National and Global. This is not uncommon in LOIs but only as to termination, expiration, choice of law and confidentiality. It is unusual in a transaction where many of the structural elements of the transaction are open. In this case, many of the important terms of the transaction were conditional, such as

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Finally, the terms of the LOI were clear that the sale and lease of the aircraft was conditioned on National obtaining acceptable financing and satisfactory documentation and that Global was to deliver an acceptable MOU from a qualified lender. Despite this seemingly clear language, it would have been helpful for the LOI to include also a provision describing what would happen on a termination or the failure of a party to perform the required conditions precedent. In a similar vein, such provisions could include terms that limit a party's damages, specifically regarding the refundability or forfeit of any security deposit, indemnification for misrepresentations, or the allocation of transaction costs and expenses.

Had National protected itself by limiting its exposure on the failure of what were stated to be conditions, it may have avoided an $8 million damages award for a deal that was never consummated.

Although this case is not a precedential decision that is binding on lower courts, it should serve as a fair warning for those parties seeking to use LOI in aircraft transactions. Even at the term sheet stage, parties should avoid the desire to take short cuts in order to conclude a deal quickly. With a careful eye to the future, aircraft lessors and financiers can use this contracting tool efficiently and avoid the many pitfalls that are present in the Global case.