Business people often make deals and then instruct their attorneys to prepare contracts. They may reach an oral understanding or agreement that later will be reflected in a formal written contract. They may exchange correspondence or other informal documents that later will be reflected in a formal contract. They may sign a letter of intent which states that they later contemplate signing a formal contract.

Sometimes, for a myriad of reasons, the parties fail to sign the formal contract. Problems arise when one party wants to proceed with the deal and the other does not (at all or on the current terms). The one who wants to proceed will argue that the parties intended to be bound when they reached their oral or written preliminary agreement, even though they contemplated signing a formal contract. This article reviews New Jersey law governing letters of intent and other preliminary agreements.

In such cases, the primary issue for the court is determining the parties’ intent. That is, whether or not the parties intended to be bound when they reached their oral or written preliminary agreement, even though they contemplated signing a formal contract. This article reviews New Jersey law governing letters of intent and other preliminary agreements.

A Summary of New Jersey Law

It is well settled in New Jersey that parties will be bound to their agreement at the time that they intend to be bound. The issue turns on whether the parties intended to be bound at the time they reached a preliminary agreement or only at the time they signed their formal contract. This question is applicable whether the parties have reached such a preliminary agreement orally or in a written document such as a letter of intent. Therefore, whether (or when) the parties have reached a binding agreement is a question of their intent.

When parties do not intend to be bound until they sign a formal contract, then they will not be bound to any oral or written preliminary agreement. They will become bound in accordance with their intent—after they sign their formal contract. However, if the parties intend to be bound by their preliminary agreement (whether oral or written), even though they contemplate signing a formal contract to memorialize their agreement, then they are bound at the time they enter into their preliminary agreement.

The parties must have reached agreement on the essential terms (a.k.a. necessary, material, major or critical terms) of their contract in order to be bound to a preliminary agreement. In this regard, a court will not refuse to enforce such a binding agreement because there are open terms or less critical terms missing from the contract. Instead, the open terms will be determined by operation of law, by subsequent agreement of the parties, or by the court implying a reasonable term, in which case the court may even hear evidence on the issue. This is so even when the parties contemplate that they will have to negotiate and agree upon additional terms (but not essential or necessary terms) to be included in the formal agreement.

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Determining the Parties’ Intent

In determining the parties’ intent, the court looks at objective evidence, such as the parties’ words and deeds, and not at subjective evidence. “The parties’ objective intent governs. A contracting party is bound by the apparent intention he or she outwardly manifests to the other party. It is immaterial that he or she has a different, secret intention from that outwardly manifested.” In general, the court considers the “the contractual terms, the surrounding circumstances, and the purpose of the contract” in determining the parties’ intent.

In the context of preliminary agreements, the case law identifies a number of factors that the courts consider to determine the parties’ intent. Perhaps the most important factor used to determine the parties’ intent is the language used by the parties in their preliminary agreement. Another factor is the presence or absence of essential terms. A third factor is the performance by one party and the acceptance of the same by the other party. Prior dealings between the parties may also be used to determine the parties’ intent. For example, the court may find that the parties intended to be bound only when they signed a formal contract when, in a prior transaction, they signed a formal contract. Other factors include whether there was anything left to negotiate so that all that was left to do was to sign the formal contract and whether the transaction was one that was so complex and substantial that they are normally or customarily made in formal contracts.

Identifying Essential Terms

Obviously, the identity of the essential or necessary terms of a contract depends on the nature of the transaction and is determined on a case-by-case basis. In cases involving a real estate contract, the closing date and buyer’s deadline to obtain a mortgage were considered essential terms. So too were the description of the real property and the purchase price. Interestingly, the case law differs on whether the type of deed given is essential.

In a case involving a commercial lease, the names of the parties, the length of the term of the lease, the annual rent, the landlord’s warranty that the mechanical systems were in working order and a provision for a security deposit were considered to be essential terms. However, provisions on maintenance and insurance were not considered essential terms. In another commercial lease case, the total area to be leased and the rental rate were considered essential terms but the commencement date of the lease was not.

In a case involving a contract for the purchase of a business, the purchase price and the seller’s obligation to vacate the premises were considered essential terms whereas the interest rate and the due date of the note to be given to the seller were considered incidental terms. Finally, normal legal jargon—the boilerplate provisions—is not considered essential.

A comprehensive review of case law follows. Cases holding that the parties intended to be bound only after signing their formal contract will be reviewed first. Next, cases holding that the parties intended to be bound by a preliminary agreement (such as a letter of intent).

Intent to be Bound only after Signing the Formal Contract

Most cases involve a party contending that there was an intent to form a binding contract at the time of the preliminary agreement. There are few New Jersey cases actually holding that the parties did not intend to be bound until they signed their formal contract. One such case is Morales v. Santiago, which involved a real estate binder and a subsequent real estate contract. The real estate being sold was a residence owned by a divorced couple. One seller signed the broker-prepared real estate binder that was subject to attorney review. The other seller, defendant’s ex-husband, did not sign the binder. The binder provided for the buyers to make an
additional deposit toward the purchase price upon signing the contract.

Sellers’ attorney prepared a contract and sent it to buyers’ attorney. Buyers signed the contract and returned it to the sellers’ attorney with a check for the additional deposit. Sellers, however, never signed the contract. Instead, they cancelled the transaction because the parties could not reach agreement on a provision allowing either party to cancel the contract if sellers were unable to purchase another property within 45 days of the date of the contract. Interestingly, this provision, which was initially unacceptable to the buyers, and not included in the binder, was included in the contract signed by the buyers.

Buyers argued that the binder was binding; presumably they did so because the contract was never signed by the sellers and thus not binding (and, at that time, unenforceable under the statute of frauds). The court, however, held that the binder did not appear to be a contract. It did not bind one of the sellers because he did not sign it. The court found that the absence of the ex-husband’s signature was evidence that the parties did not intend to treat the binder as a contract. Moreover, the parties, as reflected in the binder, expressly contemplated the execution of a formal contract.

The Appellate Division recited the applicable law as follows:

Parties may or may not be bound by their preliminary agreement when they contemplate that its terms will later be reduced to a formal written contract. Whether the preliminary agreement is binding is a matter of the parties’ intent. If the parties intend to be bound by their preliminary agreement and view the later written contract as merely a memorialization of their agreement, they are bound by the preliminary agreement. On the other hand, if the parties intend that their preliminary agreement be subject to the terms of the later contract, they are not bound by their preliminary agreement.

The Appellate Division noted that the “[a]bsence of essential terms from a preliminary agreement is persuasive evidence that the parties did not intend to be bound to it.” The Appellate Division found that the binder lacked essential terms of a contract, such as the closing date and the buyers’ deadline to obtain a mortgage, and that the parties contemplated signing a later final contract.

Moreover, the Appellate Division found that the buyers recognized that the binder was not a binding contract because they reluctantly agreed to the provision in the later contract that either party could cancel the contract if sellers could not purchase another property. In the Appellate Division’s view, the buyers could have rejected this provision if they thought that the binder was binding on the parties.

Intent to Be Bound by Preliminary Agreement

As noted, most cases involve an argument that the parties intended to be bound at the time they reached a preliminary agreement, whether orally or in writing (such as in a letter of intent). This is so even though the parties contemplated signing a formal contract. The reason that these cases exist is because the parties, for one reason or another, never got around to signing a formal contract. As a result, the parties are left with no contract at all or an argument that they intended to be bound when they reached a preliminary agreement. There are a number of cases in New Jersey holding that the parties intended to be bound to a preliminary agreement even though they contemplated signing a formal contract.

One such case, decided over sixty years ago, is Moran v. Fifteenth Ward Building & Loan Assn. There, the court held that the parties intended to be bound by a letter (although not a letter of intent); however, it was not entirely clear whether the parties contemplated a formal contract.

In Moran, defendant-landowner sent a letter to plaintiff accepting plaintiff’s offer to purchase defendant’s land. Plaintiff-purchaser sued for specific performance when
defendant-landowner reneged on the deal. In defending, defendant-landowner argued, among other things, that the description of the property to be sold and the purchase price in the letter were uncertain. The court disagreed, finding that the terms were certain. In addition, an argument was made that the alleged contract was incomplete and uncertain because certain terms were missing from the letter. However, the court held that these terms may be supplied by law.27

The court stated the law as follows:

When parties enter into negotiations and reach a tentative agreement, but do not intend to be bound until a formal contract be executed, they cannot be held to their tentative bargain. But if the negotiations are finished and the contract between the parties is complete in all its terms and the parties intend that it shall be binding, then it is enforceable, although lacking in formality and although the parties contemplate that a formal agreement shall be drawn and signed.28

In applying the foregoing law to the facts of the case, the court noted that plaintiff-purchaser contemplated a formal contract, the court held that they were outweighed by other facts to the contrary. Namely, defendant-landowner’s acceptance of $100 from plaintiff-purchaser to be applied toward the purchase price (part performance) and the absence in the letter of any requirement of a formal contract. Id. at 366-367. As a result of all of the evidence, the court held that the parties intended to be bound by the letter and a formal contract was not necessary.30

Another case, decided over forty-five years ago, is Comerata v. Chaumont, Inc.31 This case involved an oral understanding; however, it is instructive in situations involving written documents such as letters of intent.

There, the parties discussed plaintiff receiving the coat check concession at defendant’s restaurant. They discussed a one year agreement beginning on a certain date at a price of $1,000. Defendant provided plaintiff with a receipt for a $500 deposit on the coat check room “subject to contract and lease to be drawn.”32

Plaintiff operated the coat check room for four days but never signed the written agreement that defendant tendered to her. Plaintiff’s position was that the written agreement was not satisfactory because it did not comport with the parties’ oral understanding and that she was entitled to the return of her deposit.33 Plaintiff argued that the parties did not intend to be bound unless a formal contract was executed.34

The Appellate Division stated the following principles of law:

[P]arties may orally, by informal memorandum, or by both agree upon all the essential terms of a contract and effectively bind themselves thereon, if that is their intention, even though they contemplate the execution later of a formal document to memorialize their undertaking. ... The ultimate question is one of intent. Moreover, the fact that parties who are in agreement upon all necessary terms may contemplate that a formal agreement yet to be prepared will contain such additional terms as are later agreed upon will not affect the subsistence of the contract as to those terms already unqualifiedly agreed to and intended to be binding.35

The Appellate Division found that the language used in the receipt for the deposit alone would lead to the conclusion that the parties did not intend to have a binding agreement until the parties executed a formal contract. However, there was evidence of an oral understanding on the basic terms of the contract and, moreover, plaintiff partially performed on the same.36 In this regard, the Appellate Division stated:
It is strongly implied in the New Jersey cases that even where parties, having agreed upon all the terms of their contract, mean to have them reduced to writing and signed before being bound, they will nevertheless become bound if substantial acts are performed under the agreement by either side. ... The undertaking of performance, concurred in by the other party, is generally taken as strongly probative of an intention on the part of parties who have orally agreed to terms of a contract to be bound thereby notwithstanding the later execution of a formal contract is contemplated.  

Thus, the Appellate Division held that “the parties intended to be bound to the terms that they agreed upon notwithstanding it was contemplated that additional, less essential matters might be incorporated in the formal agreement later to be signed.”

A more recent case, Berg Agency v. Sleepworld-Willingboro, Inc., involved a memorandum signed by both parties. Berg, a real estate broker, brought defendant, a prospective tenant, to a commercial building owned by Bressman. Berg arranged a meeting between landlord Bressman and prospective tenant where the parties negotiated and orally agreed to the various terms of a lease. However, the meeting ended when the landlord refused to accept a shell corporation as the sole tenant; instead, he would only enter into a lease if other active companies affiliated with the prospective tenant were made parties to it.

After the meeting, Berg prepared a memorandum setting forth the agreed upon terms, which was signed by the prospective tenant. The prospective tenant also wrote a $1,000 check to the landlord with a legend indicating that it was a binder for the building. The landlord, however, refused to sign the memorandum until the active corporations were added to the memorandum. The prospective tenant, desiring to lease the building, eventually agreed and a revised memorandum was so prepared and signed by the prospective tenant and then by the landlord. The following morning, the prospective tenant telephoned the broker to advise that he had changed his mind and that he did not consider the memorandum to be binding because it did not contain all of the essential terms of a lease.

The Appellate Division court stated:

It is well settled that parties may effectively bind themselves by an informal memorandum where they agree upon the essential terms of the contract and intend to be bound by the memorandum, even though they contemplate the execution of a more formal document. ... “The ultimate question is one of intent.”

The Appellate Division noted that the memorandum “is couched in terms of a finite, bilateral undertaking, without conditions or contingencies,...” Moreover, although there was a provision contemplating the execution of a formal lease with a proviso that the tenant could not enter into possession until the execution of the formal lease, the court was of the opinion that this provision did not negate the binding memorandum.

The Appellate Division held that the parties intended the memorandum to be binding. Specifically, it noted that “both parties signed the same document so that there can be no question of the meeting of their minds on the provisions in that document.” Moreover, the language used in the memorandum suggested that there was no other intent than to be bound by its terms.

Finding that the parties intended to be bound by the memorandum even though they contemplated a formal lease, the Appellate Division next reviewed whether the memorandum contained sufficient essential terms to be enforceable. In this regard, it noted that the memorandum “sets forth in substantial detail the essential elements of a
commercial lease” including the names of the parties, the length of the term, the annual rent, the landlord’s warranty that the mechanical systems were in working order, a security deposit, etc.46 The Appellate Division concluded that “such a detailed and thought-out instrument,” which incorporated special provisions negotiated by the parties beyond the typical commercial lease, left little else for inclusion in a formal lease “except for the normal legal jardon [sic] ...”47

In response to the prospective tenant’s argument that there were a number of significant provisions missing from the memorandum (e.g., maintenance and insurance), the Appellate Division noted that this would not preclude the finding of a binding document:

[I]t is not necessary for a writing to contain every possible contractual provision to cover every contingency in order to qualify as a completed binding agreement. ... Some of these issues may be determined by the operation of law, or the parties may resolve such differences by subsequent agreement, or a contract may be silent in those respects. In any event, a contract is no less a contract because some preferable clauses may be omitted either deliberately or by neglect. So long as the basic essentials are sufficiently definite, any gaps left by the parties should not frustrate their intention to be bound.48

A recent case, Satellite Entertainment v. Keaton,49 involved an oral agreement to purchase a business. There, plaintiff was the landowner and alleged purchaser of the business; defendant was the tenant and the owner of the business, which was located in plaintiff’s building. Apparently, plaintiff asked defendant whether he was interested in selling his barbecue business and, if so, to name a price. Defendant demanded, and plaintiff agreed to pay, $175,000.50 When seller sued for specific performance, buyer denied agreeing to pay seller anything for his business. Instead, buyer claimed that seller wanted to sell his business in order to work for buyer.51

The Appellate Division found that what buyer-landlord wanted, and was willing to pay $175,000 for, was the space that seller-tenant was leasing in plaintiff’s building. The Appellate Division noted that seller’s business occupied this space and that buyer wanted to use the space for his restaurant venture.52

Buyer argued that any alleged contract to pay $175,000 to seller should be invalidated due to lack of specificity of contract terms.53 The Appellate Division disagreed, finding that the purchase price of $175,000 was firm, as was the description of what buyer was purchasing, namely, seller’s business, including the tangible assets, inventory and goodwill. The fact that they were not identified with detail in any document was because they were unimportant to buyer. As noted, what buyer really wanted was seller’s space in buyer’s building.54

Buyer also argued that the alleged contract was too vague to enforce because an interest rate and due date for the note to be given to seller were not specified by the parties. Seller, however, stated that he was not entitled to interest and that the note was due on demand.55 In this regard, the Appellate Division stated:

It is a settled principle that when the essential parts of a contract are spelled out, a court will not refuse to enforce that contract because some of its less critical terms have not been articulated. In such a case, the court will imply a reasonable missing term or, if necessary, will receive evidence to provide a basis for such an implication.56

Accordingly, the Appellate Division held that the interest rate and the due date of the note to be given to seller were incidental terms whose absence did not bar enforcement of the alleged contract between the parties. It held that the essential terms of the agreement were the purchase price and the obligation of seller to vacate buyer’s premises.57

Conclusion

Whether a preliminary agreement, such as a letter of intent, is binding is a question
of the parties’ intent, which is determined on a case-by-case basis. Parties can intend to be bound only upon the execution of a formal contract (Morales). Or, they can intend to be bound by an informal, preliminary writing (Berg) or an oral understanding (Comerata and Satellite), even though they contemplate the later execution of a formal contract, as long as they reach agreement on essential terms. This is so even when there are open non-essential terms that can be filled by operation of law, by the parties’ subsequent agreement or by the court (Berg); for example, when incidental terms are missing (Satellite) or when additional terms are intended to be included in the formal contract (Comerata).

When using a preliminary agreement, such as a letter of intent, the parties must clearly express whether they intend to be bound at that time or whether they intend to be bound only when they later sign a formal contract. Likewise, the parties may intend certain terms to be binding at that time and other terms to be binding only when they sign a formal contract; however, they must clearly express their intentions in this regard.

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1 See Moran v. Fifteenth Ward Building & Loan Assn., 131 N.J. Eq. 361, 366 (Ch. 1942) (citations omitted) (“When parties … reach a tentative agreement, but do not intend to be bound until a formal contract [is] executed, they cannot be held to their tentative [agreement]”); Morales v. Santiago, 217 N.J. Super. 496, 501-502 (App. Div. 1987) (“if the parties intend that their preliminary agreement be subject to the terms of the later contract, they are not bound by their preliminary agreement”).

2 See Morales, 217 N.J. Super. at 501-502 (“If the parties intend to be bound by their preliminary agreement and view the later written contract as merely a memorialization of their agreement, they are bound by the preliminary agreement”); Comerata v. Chaumont, Inc., 52 N.J. Super. 299, 305 (App. Div. 1958) (“parties may orally, by informal memorandum, or by both agree upon all the essential terms of a contract and effectively bind themselves thereon, if that is their intention, even though they contemplate the execution later of a formal document to memorialize their undertaking”); Berg Agency v. Sleepworld-Willingboro, Inc., 136 N.J. Super. 369, 373-374 (App. Div. 1975) (“It is well settled that parties may effectively bind themselves by an informal memorandum where they agree upon the essential terms of the contract and intend to be bound by the memorandum, even though they contemplate the execution of a more formal document”); Moran v. Fifteenth Ward Building & Loan Assn., 131 N.J. Eq. 361, 366 (Ch. 1942) (citations omitted) (“if the negotiations are finished and the contract between the parties is complete in all its terms and the parties intend that it shall be binding, then it is enforceable, although lacking in formality and although the parties contemplate that a formal agreement shall be drawn and signed”).

3 See Comerata, 52 N.J. Super. at 305 (“parties may … agree upon all the essential terms of a contract and effectively bind themselves thereon …”); Berg, 136 N.J. Super. at 373-374 (“parties may effectively bind themselves … where they agree upon the essential terms of the contract …”); id. at 376-377 (“So long as the basic essentials are sufficiently definite …”); Satellite Entertainment v. Keaton, 347 N.J. Super. 268, 276 (App. Div. 2002) (“when the essential parts of a contract are spelled out, a court will not refuse to enforce that contract …”).

4 See Satellite Entertainment, 347 N.J. Super. at 276 (“… a court will not refuse to enforce that contract because some of its less critical terms have not been articulated; … the court will imply a reasonable missing term or, if necessary, will receive evidence to provide a basis for such an implication”); Berg, 136 N.J. Super. at 376-377 (“… Some of these issues may be determined by the operation of law, or the parties may resolve such differences by subsequent agreement, or a contract may be silent in those respects; … a contract is no less a contract because some preferable causes may be omitted either deliberately or by neglect”); Goldstein Co. v. Bloomfield Plaza, 272 N.J.
Super. 59, 63 (App. Div. 1994) (citation omitted) (“the law will imply some terms if the writing indicates that a basic agreement has been entered into between the parties”).

5 See Comerata, 52 N.J. Super. at 305 (“the fact that parties who are in agreement upon all necessary terms may contemplate that a formal agreement yet to be prepared will contain such additional terms as are later agreed upon will not affect the subsistence of the contract as to those terms already unqualifiedly agreed to and intended to be binding”).


7 Marchak v. Claridge Commons, Inc., 134 N.J. 275, 282 (1993) (citations omitted). See also Onderdonk v. Presbyterian Homes, 85 N.J. 171, 183 (1981) (“Intent may be determined by examination of the contract and in particular the setting in which it was executed”).

8 See Berg, 136 N.J. Super. at 375 (the language used in the memorandum suggested that there was no other intent than to be bound by its terms). New York law is similar. In fact, considerable weight is (and should be) given to the language used by the parties in their preliminary agreement. See Adjudicate, 145 F. 3d at 549-550; R.G. Group, Inc. v. The Horn & Hardart Co., 751 F. 2d 69, 75 (2d Cir. 1984); Teachers Insurance v. Tribune Co., 670 F. Supp. 491, 499-500 (S.D.N.Y. 1987).

9 See Morales, 217 N.J. Super. at 502 (“Absence of essential terms from a preliminary agreement is persuasive evidence that the parties did not intend to be bound to it”); Berg, 136 N.J. Super. at 377 (“the presence or absence of essential contract provisions is but an element in the evidential panorama underlying a factual finding of intent and enforceability”).

10 See Comerata, 52 N.J. Super. at 306 (“The undertaking of performance, concurred in by the other party, is generally taken as strongly probative of an intention on the part of parties who have orally agreed to terms of a contract to be bound thereby notwithstanding the later execution of a formal contract is contemplated”). Again, New York law is similar. See Adjudicate, 145 F. 3d at 550; R.G. Group, 751 F. 2d at 75-76; Tribune, 670 F. Supp. at 502.

11 See Moran, 131 N.J. Eq. at 366.

12 See Adjudicate, 145 F. 3d at 550-551; R.G. Group, 751 F. 2d at 76; Tribune, 670 F. Supp. at 501-503. These factors are identified in New York case law and can be used by the parties and the courts in New Jersey to determine the parties’ intent.

13 See Morales, 217 N.J. Super. at 499.

14 See Moran, 131 N.J. Eq. at 364-365.

15 Compare Moran, 131 N.J. Eq. at 365 (not essential) with Morales, 217 N.J. Super. at 499 (essential).

16 See Berg, 136 N.J. Super. at 376.


19 See Berg, 136 N.J. Super. at 376.

21 Id. at 501.

22 Id. at 501-502 (citation omitted).

23 Id. at 502. Accord Berg, 136 N.J. Super. at 377 (“the presence or absence of essential contract provisions is but an element in the evidential panorama underlying a factual finding of intent and enforceability”).


25 Id. at 502-503. There are several New York cases with similar holdings. For example, in Reprosystem, B.V. v. SCM Corp., 727 F. 2d 257, 262 (2d Cir. 1984), the court held that the evidence and the “realities of the complex transaction” established the parties’ intent not to be bound until the execution of their formal contract. Among the evidence considered by the court was the parties’ written communications that the purchase of the business was expressly conditioned on entering into a formal contract satisfactory to both parties. Id. Also, the “magnitude and complexity” of a transaction involving a $4 million sale of six businesses incorporated in five different countries with $17 million in assets and $40 million in sales reflected “a practical business need to record all the parties’ commitments in definitive agreements.” Id. See also R.G. Group, 751 F. 2d at 76-77; Arcadian, 884 F. 2d at 72-73; Adjustrite, 145 F. 3d at 549-551.

26 131 N.J. Eq. 361 (Ch. 1942).

27 Id. at 365.

28 Id. at 366 (citation omitted).

29 Id.

30 Id. at 367.


32 Id. at 302.

33 Id. at 302-304.

34 Id. at 305.

35 Id. (citations omitted).

36 Id. at 305-306.

37 Id. at 306 (citations omitted).

38 Id.


40 Id. at 373-374 (citing Comerata, among others).

41 Id. at 374.

42 Id.

43 Id. at 375.
44 Id.
45 Id. at 375-376.
46 Id. at 376.
47 Id.
48 Id. at 376-377 (citations omitted).
50 Id. at 273.
51 Id. at 274.
52 Id. at 275.
53 Id. at 276.
54 Id.
55 Id.
56 Id. (citations omitted).
57 Id. at 277. There are several New York cases with similar holdings. See, e.g., V’Soske v. Barwick, 404 F. 2d 495, 499 (2d Cir. 1968); Tribune, 670 F. Supp. at 499 (in Arcadian and Adjustrite, the Second Circuit adopted and applied the test established by the district judge in Tribune).