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DELAWARE DECISION PROVIDES IMPORTANT LESSONS FOR DRAFTING LETTERS OF INTENT

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A recent Delaware decision provides important lessons for parties drafting letters of intent, term sheets and similar documents. In *Global Asset Capital, LLC v. Rubicon US Reit, Inc.*, the Delaware Court of Chancery temporarily enjoined defendant Rubicon US Reit, Inc. from engaging in acts alleged to have breached its obligations under a letter of intent with plaintiff Global Asset Capital, LLC. The Court found that letters of intent can create enforceable rights that it will protect.

Background

In 2009 Rubicon was considering a voluntary bankruptcy and entered into a letter of intent with GAC. The letter of intent contemplated that GAC would serve as a "stalking horse" bidder if Rubicon decided to conduct an auction sale of its assets through bankruptcy, thereby ensuring GAC a break-up fee and reimbursement of its expenses if Rubicon accepted a competing bid. The letter of intent contained a couple of typical covenants (confidentiality and "no-shop" provisions) and provided that the parties would promptly negotiate a support agreement whereby GAC would serve as the stalking horse.

Not long after executing the letter of intent, Rubicon reached an agreement with its creditors that relieved its need to seek bankruptcy protection. GAC delivered a working draft of the support agreement referenced in the letter of intent to which Rubicon did not respond.

GAC filed a lawsuit against Rubicon to enforce the letter of intent, alleging that Rubicon's disclosure of the letter of intent and its terms to its creditors breached the confidentiality and no-shop clauses of the letter of intent and alleged that Rubicon had breached its obligation to promptly negotiate a support agreement. GAC also sought to temporarily restrain Rubicon from further breaches of the letter of intent, including selling its assets without recognizing GAC as the stalking horse bidder entitled to a break-up fee and expenses under the letter of intent.

Rubicon responded that, because it was no longer seeking bankruptcy protection, the letter of intent had expired and the duty to negotiate a support agreement no longer existed. Rubicon also argued that because its board of directors had a fiduciary duty to maximize stockholder value and keep Rubicon out of bankruptcy, Rubicon was not obligated to negotiate a support agreement with GAC and make a bankruptcy filing, even though the letter of intent did not contain a "fiduciary out" permitting Rubicon to accept a superior alternative transaction.

The Delaware Court's Analysis

The Court found that Rubicon had breached the terms of the letter of intent and based its opinion on several factors.

The Court rejected Rubicon's argument that its board of directors could not faithfully discharge its fiduciary duties and honor the obligations contained in the letter of intent, holding that "contracts do not

have inherent fiduciary outs." Fiduciary outs, it reasoned, are negotiated terms, and parties cannot later extricate themselves from contracts on the basis of countervailing fiduciary duties, stating that "if you do not get a fiduciary out, you put yourself in a position where you are potentially exposed to contract damages and contract remedies at the same time you may potentially be exposed to other claims. Therefore, it is prudent to put in a fiduciary out, because otherwise, you put yourself in an untenable position."

However, the Court held that "the duty to negotiate in good faith ... is one that this Court recognizes, is one that is of commercial importance, and is one that this Court will protect." Accordingly, provisions requiring the parties to negotiate or enter into an agreement may create an affirmative obligation to do so in good faith. At a minimum, the Court noted, "radio silence is not negotiating in good faith" and Rubicon's failure to engage in negotiation of GAC's draft support agreement supported GAC's claim that Rubicon had breached this obligation.

Finally, the Court pointed out that, if the parties to letters of intent or term sheets want these documents to be non-binding, they "can readily do that by expressly saying that the letter of intent is non-binding." The Court added, "parties enter into letters of intent for a reason. They don't enter into them because they are gossamer and can be disregarded whenever situations change. They enter into them because they create rights."

On January 20, 2010, Rubicon filed for Bankruptcy Court protection and further litigation was dismissed.

Practical Lessons

The Court's decision provides a number of important lessons for parties drafting letters of intent, term sheets or similar documents:

- If the parties to a letter of intent want the document to be non-binding, they should expressly state this, or a court may decide that the document is binding.
- Without an express "fiduciary out" clause, parties to a letter of intent may not be able to rely on a fiduciary duty argument to avoid the obligations that may be created by the document.
- A clause requiring the parties to a letter of intent to negotiate or enter into an agreement may create an obligation to do so in good faith.