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When Term Sheets Attack: Timely Reminders to Take Care in Drafting Letters of Intent and Term Sheets

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Letters of intent and term sheets have long been utilized by parties to “jump-start” a transaction by delineating the transaction’s basic terms and setting forth a timeline and parameters for negotiations between the parties. Letters of intent and term sheets are typically intended to be no more than preliminary outlines of a transaction or arrangement. However, deal makers must not overlook the fact that, depending on how they are drafted, these types of documents, or at least certain provisions of these documents, may subsequently be argued by a party to include legally binding obligations. This may hold true even in the case of a simple agreement to negotiate.

Recent court decisions in Delaware and the United Kingdom provide timely reminders that parties to letters of intent and term sheets should draft these documents being cognizant of both the transaction involved and obligations surviving the transaction or the termination of negotiations. As discussed further below, these court decisions provide a number of important lessons: (1) parties intending such a document to be non-binding should expressly state so (or risk a court construing the document to be binding), (2) a party may not be able to rely on a fiduciary duty argument under Delaware law to escape an obligation in a letter of intent or term sheet where they failed to negotiate explicit “fiduciary out” language, and (3) a provision requiring a party to negotiate or enter into an agreement can create an affirmative obligation to do so, rather than being a mere preliminary indication of an intent to do so. Because letters of intent and term sheets outline rights and obligations, parties should not dismiss the need for careful attention to these documents on the basis that they are merely preliminary in nature.



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Global Asset Capital v. Rubicon US Reit (Delaware)

In late 2009, facing the likelihood of filing for bankruptcy, Rubicon US Reit, Inc. (Rubicon) entered into a letter of intent with Global Asset Capital, LLC (GAC), providing for GAC to serve as a “stalking horse” for Rubicon should Rubicon decide to auction itself in bankruptcy. The letter of intent stated that the parties would promptly negotiate the language of a support agreement setting forth the terms of such arrangement. Shortly thereafter, Rubicon and its creditors struck a deal that postponed the necessity for Rubicon to file bankruptcy and, as a result, Rubicon never commenced negotiations for a support agreement with GAC.

GAC filed a motion seeking to temporarily restrain Rubicon from further breaching the letter of intent and to prevent Rubicon from selling to another bidder in bankruptcy. GAC alleged that Rubicon had failed to promptly negotiate a support agreement as required under the letter of intent and had breached the confidentiality and “no shop” provisions of the letter of intent. Rubicon countered that because the prospect of bankruptcy had ended, the letter of intent had expired and therefore its obligation to negotiate a support agreement no longer existed. Although the letter of intent did not contain a “fiduciary out” provision, Rubicon also countered that its directors were required under their fiduciary duties to act in a manner to maximize value to stockholders, irrespective of the terms of the letter of intent.

The Delaware court based its decision that Rubicon had breached the terms of the letter of intent on several factors:

Delaware courts will not recognize an inherent fiduciary out in every contract. The court noted that fiduciary outs are bargained for a reason. As a result, if a party does not negotiate to include a fiduciary out in a letter of intent or term sheet, the party cannot later extricate itself from the contract and exclusivity arrangement on the basis of a countervailing fiduciary duty.

Provisions requiring parties to negotiate or enter into an agreement can create an affirmative obligation to do so in good faith. The court found that an agreement to negotiate contained in a letter of intent represents a concrete obligation, notwithstanding there still being material issues to be agreed upon between the parties. The court noted that “radio silence” by a party does not represent negotiating in good faith. Parties intending provisions in letters of intent or term sheets to be non-binding can protect themselves by expressly stating in the document which provisions are non-binding.

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Maple Leaf Macro Volatility Fund v. Rouvroy (United Kingdom)

Earlier in 2009, a similar case in the United Kingdom had a similar result. This case involved a hedge fund and investment manager, who purchased securities in Belvedere SA, the French vodka maker. The claimants purchased the securities based on a term sheet, executed in July 2007, with senior executives of Belvedere who were seeking to gain control of the company. The term sheet outlined that the transaction would be structured through a special purpose entity and that the executives would contribute additional collateral to the special purpose entity.

Ultimately, the transaction was concluded, but the value of the securities declined. The claimants brought suit against the executives for their failure to take certain steps required under the term sheet, including failing to contribute the additional collateral and completing certain transaction documentation. In their defense, the executives argued that (1) they never intended the term sheet to be binding (adding that, in their experience, such term sheets are not regarded as legally binding), and (2) the term sheet was too uncertain to be enforceable because it failed to include key transaction terms.

With respect to the defendant's first argument, the court reviewed the term sheet and the conduct of the parties. The English court applied an objective test of how the arrangement would have been understood by a reasonable man versed in business, rather than based on a subjective test of the intent of the parties. On this basis, the court found the term sheet to be binding and the fact that the parties continued to negotiate terms after signing the term sheet did not in and of itself color the term sheet as non-binding. With respect to the defendant's second argument that the term sheet failed to include sufficient terms to be enforceable, the court held that the term sheet was sufficiently certain. The court made this determination because the matters not covered in the term sheet were deemed to be not of fundamental importance and the parties had acted to further the transaction based on the terms that were actually included in the term sheet.

Notwithstanding the fact that this is a U.K., rather than U.S., court decision and the decision turned on particular facts and circumstances, this decision also serves as a reminder of the care needed by parties in drafting letters of intent and term sheets to ensure that the bargain negotiated in such documents reflect their actual intent.

For additional information on this issue, contact:



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