

# A POUND OF CURE

ADDRESSING SOLUTIONS IN COMMERCIAL LITIGATION

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## Deal or No Deal: Are Agreements to Negotiate in Good Faith Enforceable?

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Your company has been engaged in a lengthy negotiation to buy or sell assets. You've spent hundreds of thousands of dollars on due diligence and legal fees and countless hours exploring the potential transaction. At the eleventh hour, the other party pulls the plug, leaving you to swallow the costs of the failed transaction. To make matters worse, you were planning to re-convey the assets to a third party at a profit. Or, you are the seller and news of the failed transaction has been leaked, driving down the market value of the assets. Do you have any recourse?

The simple answer is *maybe*. It depends on the documents executed in connection with the negotiations. Increasingly, courts are willing to enforce agreements to negotiate in good faith so long as they reflect an intent to be bound and the principal terms of the final transaction have been sufficiently developed so as to be able to tell if a party is renegeing on them. But the outcome may also depend on applicable law.

Under New York law, for example, agreements to negotiate in good faith are enforceable if the parties have reached agreement on the fundamental terms and have expressed an intent to work together to finalize the remaining ones. *CanWest Global Communications Corp. v. Mirkaei Tikshoret Ltd.*, 804 N.Y.S.2d 549 (2005). If, however, material terms remain open or vague, no action will lie for failure to negotiate in good faith, even if the parties intended for the negotiation agreement to be binding. *VS&A Communications Partners, L.P. v. Former Broadcasting* (Del. Ch. 1992) (applying New York law).

Delaware law, by contrast, appears more favorably disposed toward agree-

ments to negotiate. *Gillenardo v. Conner Broadcasting Delaware Company Co.* (Del. Super. 2002) (enforcing agreement to negotiate in good faith despite lack of agreement on several key terms, including the price to be paid for radio stations).

Illinois courts have not spoken much on the issue, though one federal court interpreting Illinois law has held that, as in Delaware, an agreement to negotiate in good faith is enforceable if that was the parties' intent. *Venture Assoc. Corp. v. Zenith Data Systems*, 96 F.3d 275 (7th Cir. 1996). In that event, an action for breach of an agreement to negotiate can be maintained even where some key terms, including price, remain to be settled. *Millex Products v. Alra Laboratories*, 237 Ill. App. 3d 177 (1992).

Assuming a binding agreement to negotiate in good faith, what constitutes a breach? Again, there are variations depending on applicable law, but some universal principles have evolved.

For example, an agreement to negotiate in good faith precludes a party from later insisting on terms that do not conform to the substance of the preliminary agreement. *CanWest*. Similarly, a party may not simply abandon the negotiations or entertain offers from other bidders where the agreement to negotiate provides for exclusivity. *RGC International Investors v. Greka Energy*, 2001 WL 984689 (Del. Ch. 2001) and *Millex Products*, (Ill. App. 1992) (party cannot insist on conditions that violate the preliminary agreement or use additional conditions as a pretext to renege on the deal).

What does all this mean? The days are gone when courts will automatically dismiss agreements to negotiate in good faith as mere unenforceable "agreements to agree."

If the agreement to negotiate manifests an intent to be bound and be measured by some standard of good faith, the parties cannot walk away from the transaction based merely on a change of heart. There must be a legitimate inability to agree on a significant remaining term despite reasonable efforts.

Assuming an enforceable agreement to negotiate and a breach, what are the available damages? It might once have been safe to assume they would be capped at the out-of-pocket expenses incurred by the non-breaching party in due diligence, but it appears that is no longer the case. If the agreement to negotiate in good faith is sufficiently clear and the court finds that but for the breach, the deal would have closed, the recovery can include anticipated profits and other expectation damages. *Venture Associates; Millex; Cerberus Capital Management v. Snelling @ Snelling*, 2005 WL 4441899 (N.Y. 2005); *RGC International*.

At first, these results may seem startling. But, they make sense in the context of today's increasingly complex transactions, which can involve many moving parts and the exchange of several types of consideration, and may require the parties to take steps in preparation for the closing—incrementally and in a rational progression based on a good faith expectation that the transaction will be consummated.

In multifaceted transactions involving thousands of employees, assets in numerous locations, complex licensing and regula-

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tory issues and other complicating factors, a party cannot wait until final contract execution to begin making changes in reliance on the expected closing. Indeed, significant synergies and other value may be lost if a party must wait until *all* terms are finalized and the contract is signed. Transactions often require lead time, and parties must become more or less committed to each other as the negotiations progress. In many cases, it is necessary to reach a preliminary agreement on basic terms and lay some ground rules for finalizing the transaction, so as to allow the parties to order their

affairs, both pre- and post-closing.

Two suggestions: (1) don't sign a letter of intent, term sheet or negotiation agreement lightly—you may find yourself bound to something before you are ready; (2) an agreement to negotiate in good faith can be a powerful tool for setting the parameters of a proposed transaction and establishing a duty to work toward contract completion, so think carefully about the language of that agreement. If you want to establish a duty to attempt to negotiate the remaining terms, make it clear that your agreement is intended to be binding, and that a good

faith standard will be applied to assess performance. As with many areas of the law, the key to success lies in foresight and careful drafting.



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*If there are topics you would like us to address in the future, please email your suggestions to [james.hutchison@kattenlaw.com](mailto:james.hutchison@kattenlaw.com).*

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