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January 5, 2010

Corporate Governance Group
Client Alert

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IN A BENCH DECISION, DELAWARE COURT OF CHANCERY RULES THAT PROVISIONS OF A LETTER OF INTENT MAY BE BINDING ON THE PARTIES

Letters of intent (also commonly referred to as agreements in principle or heads of agreement) are often used in the early stages of corporate transactions to memorialize the parties' basic goals and define the parameters of the negotiations to follow. Despite the preliminary nature of these documents, deal makers must not overlook the fact that, depending on how they are drafted, letters of intent, or at least certain provisions thereof, may represent legally binding obligations. This may hold true even in the case of a simple agreement to negotiate.

For instance, in a recent ruling issued at the end of a conference call on a motion for temporary restraining order in *Global Asset Capital, LLC v. Rubicon US Reit, Inc.*,[1] the Delaware Court of Chancery temporarily restrained defendant Rubicon US Reit, Inc. ("Rubicon") from taking actions potentially in breach of certain provisions of a letter of intent with plaintiff Global Asset Capital, LLC ("GAC"). In so ruling, the Court not only clarified that obligations contained in letters of intent will be deemed binding unless the parties specifically provide otherwise, but also discussed the impact of contractual requirements that may conflict with fiduciary duties.

Background

In early November 2009, Rubicon faced a serious liquidity crisis. Anticipating that it might need to file for bankruptcy, Rubicon entered into a letter of intent with GAC on November 4th providing that GAC would serve as a "stalking horse" for Rubicon should the company decide to auction itself in bankruptcy. In exchange, GAC would receive a break-up fee and reimbursement of its expenses in the event that Rubicon accepted a competing bid. Along with confidentiality and no-shop agreements on the part of Rubicon, the letter of intent stated that the parties would

[1] *No. 5071-VCL (Del Ch., Nov. 16, 2009).*

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promptly negotiate the language of a support agreement setting forth the terms under which GAC would serve as the stalking horse in a bankruptcy auction.[2] The parties further agreed that the letter of intent would terminate if Rubicon filed for bankruptcy before the support agreement could be finalized. Soon after signing the letter of intent, Rubicon reached an understanding with its creditors that relieved its liquidity crisis and any urgent need to seek bankruptcy protection. As a result, even though GAC forwarded a working draft of the support agreement, Rubicon apparently failed to begin negotiations of that draft with GAC.

GAC brought suit against Rubicon to enforce the letter of intent, claiming that by disclosing the existence and terms of the letter of intent to gain concessions from its creditors outside of a bankruptcy proceeding, Rubicon breached the confidentiality and no-shop provisions of the letter of intent. GAC also claimed that Rubicon breached its obligation under the letter of intent to promptly negotiate a support agreement. In support of its lawsuit, GAC filed a motion seeking to temporarily restrain Rubicon from further breach of the letter of intent and, most important, from selling to another bidder in bankruptcy without recognizing GAC's status as the stalking horse bidder.

In its defense, Rubicon argued that because it was no longer in danger of entering bankruptcy, the letter of intent had expired and the duty to negotiate no longer existed. Furthermore, although the letter of intent did not contain a "fiduciary out" allowing Rubicon to terminate any obligations that it may have owed to GAC thereunder in order to accept a superior alternative transaction, Rubicon argued that because its directors were duty bound to keep the company out of bankruptcy in order to maximize value to shareholders, the company was justified in not proceeding with negotiation of a support agreement with GAC and a bankruptcy filing.

The Court's Analysis

In deciding to grant GAC's motion for a temporary restraining order, the Court explained that "sufficiently definite" letters of intent do indeed create enforceable obligations. According to the Court, "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." The Court further observed that if parties wish a letter of intent to be nonbinding, they "can readily do that by expressly saying that the letter of intent is nonbinding."

Although it is unclear from the transcript whether the letter of intent between GAC and Rubicon explicitly required "good faith" negotiations, it is clear that the letter of intent contemplated that the parties would promptly negotiate the terms of a support agreement. The Court found that an agreement to negotiate contained in a letter of intent represents a concrete obligation and, consequently, GAC's allegation that Rubicon failed to begin negotiations over the support agreement constituted a colorable claim that Rubicon breached this obligation. In this regard, the Court noted 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."[3] Furthermore, the Court added that "radio silence is not negotiating in good faith."

[2] It is not clear from the opinion whether or not the negotiation provision specifically required the parties to negotiate in good faith.
[3] Citing *RGC International Investors v. Greka Energy*, C.A. No. 17674 (Del. Ch. Aug. 22, 2001). Notably, the term sheet litigated in RGC explicitly required that the parties negotiate *in good faith*.

The Court next addressed Rubicon's contention that, in light of the arrangement with its creditors, its board could not, consistent with its fiduciary duties, honor the obligations contained in the letter of intent, even if those obligations were enforceable as a legal matter The Court rejected this argument, noting that "contracts do not have inherent fiduciary outs." The Court then proceeded to remind counsel that "[p]eople bargain for fiduciary outs because … 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."[4] In other words, Rubicon could not rely on its board's fiduciary obligations to abrogate the requirements of a binding contract with GAC.

Conclusion

Although the Court's oral decision in *Global Asset Capital, LLC v. Rubicon US Reit, Inc.* may be of limited precedential value, it does provide an excellent insight into the importance that Delaware courts attribute to letters of intent. Because agreements of this nature can be found to create legally enforceable obligations, parties considering an M&A or other commercial transaction should not lightly enter into letters of intent, agreements in principle and the like. Moreover, in negotiating the terms of a letter of intent, they must be as careful in explicitly defining their respective rights and obligations as they would be in negotiating definitive contractual arrangements. For instance, if the parties want any particular aspect of the letter of intent not to be binding, they must expressly so provide. Also, a party to a letter of intent that explicitly requires a negotiation must at least begin to do so, even if that party ultimately intends (because of a change in circumstances or otherwise) to pursue a different course of action. Finally, absent an express fiduciary out (which would likely require the payment of a break-up fee), a party to an otherwise binding letter of intent cannot assume that competing fiduciary duties will allow it to avoid compliance with binding contract terms, no matter how preliminary in nature.

[4] For further discussion of this issue, *see* our Client Alert entitled *Delaware Court of Chancery Holds That Directors' Fiduciary Duties Do Not Compel Breach of Contractual Obligations* (February 19, 2009).

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Corporate Governance Group, whose names and contact information are provided below.

Beijing
Units 05-06, 15th Floor, Tower 2
China Central Place, 79 Jianguo Road, Chaoyang District
Beijing 100025, China

Anthony Root	+86-10-5969-2777	aroot@milbank.com
Edward Sun	+86-10-5969-2772	esun@milbank.com

Frankfurt
Taunusanlage 15
60325 Frankfurt am Main, Germany

Norbert Rieger	+49-69-71914-3453	nrieger@milbank.com

Hong Kong
3007 Alexandra House, 18 Chater Road
Central, Hong Kong

Anthony Root	+852-2971-4842	aroot@milbank.com
Joshua Zimmerman	+852-2971-4811	jzimmerman@milbank.com

London
10 Gresham Street
London EC2V 7JD, England

Stuart Harray	+44-20-7615-3083	sharray@milbank.com
Thomas Siebens	+44-20-7615-3034	tsiebens@milbank.com

Los Angeles
601 South Figueroa Street
Los Angeles, CA 90017

Ken Baronsky	+1-213-892-4333	kbaronsky@milbank.com
Neil Wertlieb	+1-213-892-4410	nwertlieb@milbank.com

Munich
Maximilianstrasse 15 (Maximilianhoefe)
80539 Munich, Germany

Peter Nussbaum	+49-89-25559-3636	pnussbaum@milbank.com

New York
One Chase Manhattan Plaza
New York, NY 10005

Scott Edelman	+1-212-530-5149	sedelman@milbank.com
Roland Hlawaty	+1-212-530-5735	rhlawaty@milbank.com
Thomas Janson	+1-212-530-5921	tjanson@milbank.com
Robert Reder	+1-212-530-5680	rreder@milbank.com
Alan Stone	+1-212-530-5285	astone@milbank.com
Douglas Tanner	+1-212-530-5505	dtanner@milbank.com

Singapore
30 Raffles Place, #14-00 Chevron House
Singapore 048622

David Zemans	+65-6428-2555	dzemans@milbank.com
Naomi Ishikawa	+65-6428-2525	nishikawa@milbank.com

Tokyo
21F Midtown Tower, 9-7-1 Akasaka, Minato-ku
Tokyo 107-6221 Japan

Darrel Holstein	+813-5410-2841	dholstein@milbank.com

Washington, DC
International Square Building, 1850 K Street
Washington, DC 20006

Glenn Gerstell	+202-835-7585	gerstell@milbank.com