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NORTH CAROLINA BUSINESS COURT RECOGNIZES DUTY TO NEGOTIATE CONTRACTS IN "GOOD FAITH"

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By Cliff Brinson, Jackson Moore and Toby Coleman

Until there's a binding contract, are you free to walk away from negotiations without penalty? Not necessarily. The North Carolina Business Court recently held that in certain circumstances parties have a duty to negotiate in good faith and may have to pay damages if they breach that duty by improperly terminating contract negotiations.

In the June 2015 decision of *RREF BB Acquisitions, LLC v. MAS Properties, L.L.C., et al.*, 2015 NCBC 58, the North Carolina Business Court held that a "claim for breach of a duty to negotiate in good faith may be viable" in North Carolina. In that case, a real estate developer, his wife and his company asserted various claims against one of their lenders after negotiations to restructure and extend their multi-million dollar loans broke down at the eleventh hour. The parties engaged in extensive negotiations regarding the terms of the restructured loans, and by their last meeting the parties agreed to a number of terms for the restructured loans. After the last meeting, the bank unilaterally ended negotiations.

The real estate developer, his wife and his company contended that even if the parties had failed to reach a binding contractual agreement, the bank had effectively agreed to continue negotiations in good faith and breached that agreement by cutting off negotiations. As evidence of this agreement to negotiate in good faith, they pointed to bank officials' actions during negotiations, including handshakes and a statement that the deal would close by the end of the year.

The bank moved for summary judgment on the claim of breach of duty to negotiate in good faith, contending that North Carolina law does not recognize such a claim. In denying the motion for summary judgment, Judge Gregory P. McGuire of the North Carolina Business Court acknowledged that North Carolina has never before recognized such a claim, but noted that other federal and state courts (including the Fourth Circuit Court of Appeals applying West Virginia law) have recognized the claim. Judge McGuire wrote that the Business Court saw "no reason that an agreement to continue negotiating in good faith would not be enforceable, provided that it met all of the requirements for contract formation under North Carolina law." Turning to the facts of the case, Judge McGuire held that a jury could conclude that the parties' "words and conduct established an agreement to continue negotiating in [an] attempt to finalize the terms of the agreement."

Although it remains to be seen how the North Carolina appellate courts will rule, for now the *RREF* decision opens the door for litigants in North Carolina to assert claims for breach of the duty to negotiate in good faith. Furthermore, the laws of other states (including New York and Delaware) that potentially could apply to transactions negotiated by North Carolina businesses already recognize such a duty. North Carolina businesses therefore should remember the risks as they conduct contract negotiations.

In considering whether a duty to negotiate in good faith applies, parties should keep the following in mind:

- The duty to negotiate is an independent contractual obligation that does not automatically apply every time two parties start negotiating. Generally speaking, the parties must expressly agree to negotiate in good faith to create such a duty.
- Some courts, however, have been willing to find an implicit agreement to negotiate in good faith depending upon the parties' words or course of conduct. Correspondence, non-disclosure agreements and other documents that include representations that the parties will negotiate in good faith could be evidence that a duty to negotiate in good faith existed. Term sheets and letters of intent may also be evidence that a duty to negotiate in good faith existed, even where they contain disclaimers that they do not constitute an offer and are only to be used to facilitate negotiations.
- Thus, to create a duty to negotiate in good faith in jurisdictions that recognize the duty, a written agreement between the parties agreeing to such a duty is the best approach. Conversely, to avoid creating such a duty, consider entering into a written agreement expressly disclaiming any agreement to negotiate in good faith and stating that the parties are not entering into any kind of agreement until it is reduced to a separate writing and signed by both parties. While such agreements can be modified by later oral agreements or conduct, they are preferable to not having such an agreement.
- The duty to negotiate in good faith is only a duty to negotiate; parties subject to the duty are not required to come to a final agreement. Courts recognize that negotiations may be unsuccessful, even when parties act in good faith. Courts have not drawn clear lines for what constitutes a breach of the duty to negotiate in good faith, and rulings depend greatly on the facts at issue. Accordingly, it is helpful to document that you are acting in good faith. For example, rather than simply ceasing communications, consider communicating in writing your best and final offer to the other side before cutting off negotiations and describing the good faith basis for the offer, even if you fully expect the offer to be rejected. Such correspondence, if crafted carefully, can be useful should litigation regarding the negotiations ensue.

Where a duty to negotiate in good faith exists, courts have generally held that the damages available for a breach of the duty are restitution damages (e.g., how much was spent during the course of the negotiations) and not expectation damages (e.g., the profits that would have been realized if the deal had been finalized). It is also possible that the conduct giving rise to a breach of the duty to negotiate in good faith could give rise to other "bad faith" claims. Indeed, in the *RREF BB Acquisitions* case, the North Carolina Business Court observed that actions that establish that a party breached its duty to negotiate in good faith "could be sufficient to constitute conduct that is unfair or deceptive within the meaning of [North Carolina's unfair and deceptive trade practices statutes]." Such "bad faith" claims may provide a basis for recovering additional and punitive damages, as well as attorneys' fees.

The legal landscape for complex contract claims is evolving and a possible duty to negotiate in good faith is now part of that landscape. Expressly addressing the duty at the outset of contract negotiations, carefully documenting ongoing negotiations and effectively communicating with the other side are ways to manage the risks associated with this duty.

For more information tailored to your particular situation, please contact your Smith Anderson lawyer.

PROFESSIONALS

Clifton L. Brinson

Jackson W. Moore

Toby R. Coleman

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