UT LAW CLE | THE UNIVERSITY OF TEXAS SCHOOL OF LAW

PRESENTED AT

39th Annual Corporate Counsel Institute

May 11-12, 2017
Houston, Texas

Contract "Killer Clauses"

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Pitfalls and landmines to avoid in bet-the-company and other scenarios, including unexpected consequences of documents such as Memoranda of Understanding, Letters of Intent, Non-Disclosure Agreements and Commercial Arrangements[1]

In day-to-day practice, transactional attorneys and corporate counsel encounter certain contractual provisions or variants of those provisions on a routine basis. These often include provisions in letter agreements that are intended to serve as a starting point for further negotiations – sometimes titled as a Memorandum of Understanding, Letter of Intent, Memorandum of Terms, etc. These also include provisions in non-disclosure agreements, which are often entered into well before the ultimate nature of the parties' relationship is known. Consulting agreements, service agreements and license agreements are also common-place agreements that include familiar provisions. These agreements may appear so frequently that it can be easy to gloss over the specific phrasing while focusing on economic terms and other more heavily-negotiated terms. Some of the "standard" terms commonly seen in these types of documents may have surprising consequences when applied to a bet-the-company or other significant transaction between the parties.

Non-Binding Memoranda of Understanding / Letters of Intent

Whether dealing with an enterprise software license, a co-marketing arrangement, or a major product order, there are times when the momentum of negotiations is captured in the form of a memorandum of understanding, term sheet or letter of intent. These preliminary documents help capture that state of the parties' negotiations as of a point in time, and then serve as a framework for further negotiations. Often they will include language expressly stating that the letter is non-binding, sometimes excluding certain provisions such as confidentiality provisions, governing law, and the like. Depending on the nature of the negotiations, there may be certain areas where the parties want to continue discussions, but do not yet have specific terms agreed, so they may want the document to refer to continued negotiations in good faith.

Courts called on to interpret and apply "non-binding" letters of intent and similarly titled documents have come to differing conclusions based on, among other things:

- Whether the letter of intent includes express language regarding good faith negotiations;
- The implied covenant of good faith and fair dealing observed in most states, although to a varying extent; and
- The parties' subsequent conduct and communications.

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[1] These materials were prepared with the assistance of Paul R. Tobias and Andrew W. Smetana of Vinson & Elkins, LLP, in connection with the Corporate Counsel Institute CLE presentation provided on Thursday, May 11, 2017 by Kevin Fiur, Executive Vice President and Chief Legal Officer of iFly Indoor Skydiving, and Catherine Bedell, General Counsel and Secretary of Vapor IO, Inc.

Surprisingly, some courts have found that a party's breach of a non-binding letter of intent can give rise to the recovery of expectation or benefit-of-the-bargain damages, while other courts have found that the aggrieved party can only recover reliance damages, or that there can be no recovery at all. The significance of preliminary agreements depends in part on the parties' subsequent conduct and in part on the applicable governing law.

Negotiating in Good Faith

In *SIGA Technologies, Inc. v. PharmAthene, Inc.*, 67 A.3d 330 (Del. 2013), the Delaware Supreme Court considered the parties' obligations under a term sheet that was not signed and contained a footer on each page stating "Non Binding Terms".[2] The term sheet described a potential license transaction between SIGA and PharmAthene. SIGA was developing a treatment for small pox, but had limited financial resources and was facing a threat of being delisted from NASDAQ.[3] PharmAthene wanted to merge the two companies, but SIGA initially preferred a licensing deal.[4] After negotiating a detailed term sheet for the license transaction, and after SIGA presented that term sheet to its Board of Directors, the parties decided to instead pursue a potential merger.[5] When negotiating the merger term sheet, the parties included the following language in the merger term sheet:

> SIGA and PharmAthene will negotiate the terms of a definitive License Agreement in accordance with the terms set forth in the Term Sheet … attached on Schedule 1 hereto. The License Agreement will be executed simultaneously with the Definitive [Merger] Agreement and will become effective only upon the termination of the Definitive [Merger] Agreement.[6]

At various times throughout the subsequent negotiations regarding the merger, PharmAthene continued to express interest in obtaining the license in the event the merger didn't work out.[7] In a subsequent loan transaction between the parties and the definitive merger agreement that was entered into between the parties, they agreed that they would "negotiate in good faith with the intention of executing a definitive License Agreement in accordance with the License Agreement Term Sheet…" in the event the merger was not consummated (rather than executing the license simultaneously with the definitive merger agreement).

In the parties' subsequent merger agreement, the parties agreed that, if the merger was terminated, the parties would negotiate in good faith a definitive license agreement in accordance

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[2] *SIGA Technologies, Inc.,* 67 A.3d at 336-37.

[3] *Id.* at 334.

[4] *Id.*

[5] *Id.* at 335-36.

[6] *Id.* at 336-37.

[7] *Id.* at 337.

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First appeared as part of the conference materials for the
39th Annual Corporate Counsel Institute session
"Contract "Killer Clauses""