Who Says There Is No Such Thing as an Agreement to Agree?

Letters of Intent and Recovering Damages for Lost Business Opportunities

A letter of intent is a device used to reflect the preliminary understandings of parties who are planning to enter into a commercial contract or commercial lease. It can outline how parties will achieve an asset purchase, what terms will apply to a supply claim contract, or how retail space will be let. Many cases have analyzed what happens when parties do not sign a final agreement after undertaking these preliminary negotiations. In precontractual liability cases, the touchstone issue for determining whether the parties have reached an enforceable agreement is intent: Does the evidence indicate that the parties intended that the letter of intent bind them so that it formed an incomplete but nevertheless enforceable agreement. To evaluate whether the parties have indicated such an intent, the courts typically examine two critical factors. First, does a letter of intent express an intent to engage in further negotiation, thereby indicating that the parties consider that the agreement is merely preliminary? Second, does a letter of intent cover all the essential terms of the parties’ agreement? See, e.g., Mass Cash Register Inc. v. Contrex Sys. Corp, 901 F. Supp. 404, 415 (D. Mass. 1995) (“when parties contemplate the execution of a formal written agreement, a strong inference is made that they do not intend to be bound by earlier negotiations or agreements until the final terms are settled.”) (interpreting Mass. law); Gel Sys., Inc. v. Hyundai Eng’g and Constr. Co., Inc., 902 F.2d 1024, 1027 (1st Cir. 1990) (“The fact that a writing refers to a formal document to be executed in the future does not automatically prevent the initial writing from being binding” but it is strong evidence that “the parties do not intend to be bound until the formal document is hammered out”) (interpreting Mass. law); Goren v. Royal Invs. Inc., 25 Mass. App. Ct. 137, 139–41 (Mass. App. Ct. 1987) (holding an agreement to buy building was an enforceable agreement even without a signed purchase and sale agreement when “all significant economic issues were resolved in the preliminary agreement” and “[t]he transaction was not particularly complex and it did not require intricate final documents”); Cnty. Builders, Inc. v. Indian Motorcycle Assocs. Inc., 44 Mass. App. Ct. 537, 556 (Mass. App. Ct. 1998) (“it is not enough if parties negotiating have agreed upon certain important terms if there has been no agreement on other essential elements of the undertaking.”).

But what happens when a letter of intent does not contain all of the essential terms of a contract or does not indicate that the parties had reached a final agreement? In the past, a court would deem this situation as merely “an agreement to agree” that created no enforceable right for either party. Recently, however, some courts increasingly have recognized a right to recovery based on a failure to negotiate in good faith even though the parties clearly had not reached agreement on the essential terms of a contract. This developing line of cases recognizes that while a letter of intent may not itself indicate that a party intended to be bound, the letter of intent constituted a preliminary agreement to negotiate further in good faith, and the failure by one party to do so constituted a breach of the covenant of good faith and fair dealing so the other party may possibly recover based on that theory. Such a breach precludes a party from withdrawing from further negotiations when to do so effectively deprives the other party of the fruits of their preliminary contract. This article will focus on lawsuits involving letters of intent, preliminary commercial contracts, and precursors to commercial contracts that plaintiffs allege defendants have breached, resulting in “lost business opportunities” that warrant damages involving complicated value determinations due to the uncertainties of the parties’ circumstances.

Tracing the Case Law

The emerging case law can be traced to an increasing recognition among courts that many complex commercial transactions often proceed in stages and involve,
indeed require, interim partial agreements to enable the parties to invest the effort and resources necessary to achieve the full-scale comprehensive deals that the parties ultimately seek. In this line of cases, a partial preliminary contract neither constitutes the ultimate commercial agreement contemplated by the parties nor “guarantees that the parties will conclude” the agreement. This interim agreement “precludes, however, renouncing the deal, abandoning the negotiations, or insisting on conditions that do not conform to it.” Fickes v. Sun Expert, Inc., 762 F. Supp. 998, 1001 (D. Mass. 1991).

In one of the earliest cases to have recognized a right to recovery when the parties’ negotiations did not result in a final agreement, Air Technology Corp. v. General Elec. Co., 347 Mass. 613 (1964), the Supreme Judicial Court of Massachusetts found a preliminary agreement between the parties was enforceable and measured damages based on the fair value of the lost opportunity and the probability of successful negotiations of an ultimate commercial contract. The parties were working together to try to help General Electric obtain a contract with the U.S. Air Force to aid the Air Force’s initiative to “establish installations in North America for detecting and determining the direction and yield of nuclear detonations by methods including the use of electromagnetic sensors.” Id. at 614. The plaintiff had considerable experience detecting electromagnetic radiation and was critical in helping General Electric ultimately obtain the contract with the Air Force. The parties agreed that the plaintiff would be one of General Electric’s “team members,” which the superior court found to mean that the plaintiff would be awarded a subcontract for the electromagnetic sensor if General Electric was awarded the prime contract by the Air Force. General Electric was ultimately awarded the contract but failed to award the subcontract to the plaintiff. The superior court found that General Electric had failed to act in good faith when it failed to negotiate with the plaintiff for the subcontract after General Electric received the Air Force contract. The superior court awarded the plaintiff damages based on the lost opportunity to recover the costs that it expended as well as a fair profit. On appeal, the Supreme Judicial Court of Massachusetts remanded the case to the superior court, limited to the issue of damages, holding that the plaintiff’s damages must be tempered by the uncertainties of the situation, that is, by factoring in the likelihood that the Air Force would have

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approved of the subcontract—a requirement of the contract that it awarded to General Electric. In recognizing the difficulties in measuring such damages, the Supreme Judicial Court of Massachusetts held that “the amount of the recovery cannot be less than the higher of two available alternative measures of damages viz. (a) the value reasonably expected by AT [Air Technology] in the performance of the joint arrangement, and (b) the fair value of AT’s contribution to that arrangement.” Id. at 628–29 (emphasis added).

In Stoneridge Control Devices, Inc. v. Teleflex, Inc., 17 Mass. L. Rptr. 335 (Mass. Super. 2004), a case tried before the Business Litigation Session of the Suffolk Superior Court by this author, the superior court considered how a court should apply these principles to determine whether a letter of intent that required Teleflex to name Stoneridge its supplier of certain component parts and to execute a commercial contract with it if Stoneridge satisfied certain technical requirements and conditions. Thus, the letter of intent here contained none of the essential terms of a commercial contract but plainly agreed to award the business to Stoneridge if it satisfied the conditions in the letter of intent. After Teleflex awarded the manufacturing contract to a competitor, Stoneridge filed a lawsuit alleging that it had satisfied the conditions in the letter of intent and was entitled to recover as damages the profits that it would have made if Teleflex had executed a commercial contract as it promised in the letter of intent. The judge sent the case to a jury to determine whether Teleflex had breached the covenant of good faith and fair dealing under this preliminary understanding. The jury found that Stoneridge satisfied the conditions required of it under the letter of intent, but Teleflex had acted in bad faith by awarding the supply contract to the competitor. The jury found that Teleflex had deprived Stoneridge of the benefit of its bargain—the promise that upon meeting the technical requirements, it would receive the commercial contract. Following the Supreme Judicial Court of Massachusetts holding in Air Technology, the superior court instructed the jury that Stoneridge was entitled to recover expectation damages measured by the value of this lost business opportunity, and the jury returned a verdict of $2M for that loss. 347 Mass. at 627.

Courts in other jurisdictions have similarly followed this trend towards recognizing precontractual agreements as enforceable where a party has breached its obligation to negotiate in good faith and have awarded damages based on the value of lost business opportunities. In Pharmathene, Inc. v. Siga Technologies, Inc., two Delaware biodefense companies had a precontractual agreement evidenced in a license agreement term sheet with the intent to establish a partnership to further develop and commercialize a drug for the treatment of Smallpox. 2011 WL 4390726, at *5 (Del. Ch. Sept. 22, 2011), reargument denied, CIV.A. 2627–VCP, 2011 WL 6392906 (Del. Ch. Dec. 16, 2011). After
agreeing to certain initial terms in the license agreement, the parties then began discussing a merger and agreed that if the merger fell through they would enter into a definitive license agreement using “best efforts to take such actions as may be necessary or reasonably requested by the other parties hereto to carry out and consummate the transactions contemplated in this transaction.” Id. at *8. After both the merger and attempts to negotiate a final licensing agreement were unsuccessful, PharmAthene filed a seven-count lawsuit that included breach of contract, promissory estoppel, and unjust enrichment allegations. The court found that SIGA acted in bad faith in relation to its duty to negotiate the terms “substantially similar” to those in the term sheet. Id. at *22, *23.

In Columbia Park Golf Course, Inc. v. City of Kennewick, 160 Wash. App. 66, 73 (Wash. Ct. App. 2011), reconsideration denied (Apr. 11, 2011), a developer and a Washington city formed a “development option agreement” for the purpose of developing a city park in which the city agreed that it would not negotiate with any other developer during its term. The Washington Court of Appeals found the agreement to be a “contract to negotiate,” which represented “an objective manifestation of mutual assent to definite terms, supported by mutual promises as consideration.” Id. (citing Keystone Land & Dev. Co. v. Xerox Corp., 152 Wash. 2d 171, 176 (2004); King v. Riveland, 125 Wash. 2d 500, 505 (1994)). The court noted that “[c]ities often enter such agreements with potential developers of public land to help the project proponents gather financial resources for environmental and technical studies, seek grants or permits, and test interest among prospective commercial tenants.” Id. at 78.

While the developer was seeking approvals, the city received another development proposal and later formed a development agreement with that developer. The jury verdict favored the first developer based on a breach of the development option agreement and a breach of the covenant of good faith and fair dealing.

A common theme in most of these cases is that during the course of negotiations the parties formed interim agreements that, while not enforceable as commercial contracts, were subject to the covenant of good faith and fair dealing and served as the basis for an ongoing duty to negotiate. See, e.g., Pharmathene, 2011 WL 4390726, at *23 (holding that a precontractual term sheet became operative through later agreements and required the parties to negotiate in good faith terms “substantially similar” to those contained in the term sheet). Some courts will distinguish such interim agreements from “agreements to agree,” but they can be enforceable agreements, supported by consideration, that lead the parties down paths of further negotiation.

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What Is the Impact of a Disclaimer on the Duty to Negotiate in Good Faith?

As noted above, in determining whether a letter of intent will itself be deemed to constitute an enforceable commercial agreement, courts routinely look at a number of factors, including the extent to which the parties have covered all the essential terms of a contract. Another factor is whether the parties themselves used language to indicate whether they intend the agreement to be merely preliminary. The question arises whether such a disclaimer in a letter of intent will merely prevent the formation of a commercial agreement or whether it will act to eliminate any binding obligation to even negotiate in good faith. In Schwambeck v. Federal-Mogul Corp., 31 Mass. App. Ct. 390, 417 (1991), 412 Mass. 703 (1992), the Massachusetts Appeals Court and the Massachusetts Supreme Judicial Court reached opposite conclusions as to this question.

The facts were as follows: in 1980, Federal Mogul Corporation entered into a letter of intent to sell some of its assets to Schwambeck. The letter of intent provided that “this letter is not intended to create, nor do you or we presently have any binding legal obligation whatever in any way relating to” the sale of the assets at issue. After several months of negotiations, Federal Mogul sold the assets to another bidder. During the negotiations, it not only failed to disclose to Schwambeck that there was another interested party, but it falsely stated that there was not. Schwambeck sued, claiming that the letter of intent was an enforceable contract because, notwithstanding the disclaimer above, it also stated that the parties would “proceed in good faith in the negotiation of a binding definitive agreement.” Schwambeck claimed that the clandestine negotiations with another buyer violated the obligation to negotiate in good faith and entitled him to recover damages for breach of that agreement. The trial court awarded Schwambeck damages totaling $32.5 million dollars. Although the Massachusetts Appeals Court reversed the judgment, finding that the trial judge had overly enlarged the scope of the duty to negotiate in good faith (noting that the duty imposed no obligation to continue to negotiate where a party has a change of heart and “means something less than unremitting efforts to get to ‘yes’ with the players at all times playing their cards face up”), but concluded that the parties’ disclaimer did not eliminate the obligation to negotiate in good faith or to preclude liability if a party failed to do so. The Massachusetts Supreme Judicial Court reversed. Relying on the “settled principle of contract law that ‘[a] promise made with an understood intention that it is not to be legally binding, but only expressive of a present intention, is not a contract’ (id. at 706), the Supreme Judicial Court of Massachusetts concluded that such a disclaimer does not merely negate a final commercial agreement but effectively eliminates any binding obligation to negotiate in good faith at all. Having concluded that the parties did not bind themselves contractually to negotiate in good faith, the Supreme Judicial Court did not address what constitutes an obligation to negotiate in good faith or whether
Federated Mogul breached any such obligation. While the Supreme Judicial Court was more cursory in its reasoning than the subject deserved, its decision is likely to be treated with deference by other courts that consider the effect of a disclaimer upon the obligation to negotiate in good faith.

**So How Should an Assessor Measure a Loss Resulting from a Failure to Negotiate?**

Determining the value of the lost opportunity depends on many factors, including the approximate amount that the breached against party would have obtained from a final, executed commercial contract and the probability that the parties would have executed it. A letter of intent may establish some of those facts, but, if not, a court can make appraisals. As the Supreme Judicial Court of Massachusetts held in the *Air Technology* case, the recovery amount should not be less than the higher of two alternative measures of damages—the value extended to the process by the party that did not breach the agreement and the fair value of that party's contribution to the endeavor. 347 Mass. at 629.

Courts in other jurisdictions have approached the issue of how to assess damages with enough certainty in different ways in these situations. In *Pharmathene*, the court noted that “the general rule against recovery of uncertain damages has been relaxed to permit recovery of the lost business opportunity of a letter of intent, *i.e.*, a contract dependent on an uncertain contingency, so long as the value of the ‘lost chance’ is fairly measurable.” *Pharmathene*, 2011 WL 4390726, at *32. The court noted that other Delaware courts have awarded damages “fairly approximating the value of a lost business opportunity.” *Id.* The court concluded that it could not award the present value of Pharmathene’s lost profits on the license agreement because Pharmathene may not have profited at all and because the parties never consummated the deal, but the court did not rule out the possibility in other cases of awarding the net present value of “whatever the parties had, or in good faith demonstrably would have, agreed to at the time that the contract was breached.” *Id.* at *33. Instead, the court awarded Pharmathene expectation damages in the form of a future payment stream, subject to a deduction for expenses, if and when commercial sales of the product started. *Id.* at *38. Attorneys should not assume that all courts will embrace this more lenient approach.

In *Columbia Park*, the Washington Court of Appeals also struggled with how to measure damages, specifically whether the correct measure should be expectation damages or reliance damages. *Columbia Park*, 160 Wash. App. at 91. The majority concluded that expectation damages were appropriate for this type of claim, at least in principle. The court stated, “we find no basis in Washington law to adopt a special rule that always forecloses the usual expectation measure of damages—essentially a conclusive presumption that expectation damages can never be proved with reasonable certainty—when a longstanding ‘reasonable certainty’ requirement already guards against speculative awards.” *Id.* at 84 (citations omitted). The court noted the evolution of respected commentator Professor Allan Farnsworth, whose treatise on contracts had previously rejected expectation damages in these types of cases, but who changed his position on this issue. The court also quoted at length from an earlier decision in the Seventh Circuit for which Judge Posner had explained why consequential damages should be recoverable when the facts suggested that good faith negotiations would have produced an enforceable contract:

> If, quite apart from any bad faith, the negotiations would have broken down, the party led on by the other party’s bad faith to persist in futile negotiations can recover only his reliance damages—the expenses he incurred by being misled, in violation of the parties’ agreement to negotiate in good faith, into continuing to negotiate futilely. But if the plaintiff can prove that had it not been for the defendant’s bad faith the parties would have made a final contract, then the loss of the benefit of the contract is a consequence of the defendant’s bad faith, and, provided that it is a foreseeable consequence, the defendant is liable for that loss—liable, that is, for the plaintiff’s consequential damages. *Venture Associates Corp. v. Zenith Data Sys. Corp.*, 96 F.3d 275, 278 (7th Cir. 1996) (citing Steven J. Burton & Eric G. Andersen, *Contractual Good Faith: Formation, Performance, Breach, Enforcement*, §8.4.2.3 (1995)).

Not all courts have embraced the notion that the breach of an interim agreement justifies an award of expectation damages. In *Gemini Investors, Inc. against AmeriPark, Inc.*, 643 F.3d 43 (2011), the First Circuit confronted whether the plaintiff should receive expectation damages for breach of a “non-binding” letter of intent that included an exclusivity clause prohibiting the defendant from negotiating with anyone other than the plaintiff for a specified period. Applying Massachusetts law, the First Circuit rejected the argument that the “lost opportunity theory of causation” applied to such facts. Reading the *Air Technology* decision, which the First Circuit described as “confusing,” quite narrowly, the First Circuit distinguished the holding of the Supreme Judicial Court of Massachusetts in that case on the grounds that it involved an agreement that “obliged” General Electric to award the subcontract to the plaintiff if the Air Force approved the subcontract, noting that there is a meaningful difference between the duty to award a subcontract and a duty to refrain from dealing with third parties.

Even if *Air Technology* holds that a breach of the former duty can cause the type of lost opportunity injury asserted by Gemini, it does not necessarily follow that a breach of the latter duty does as well. Put differently, in *Air Technology* the plaintiff actually lost a contractually guaranteed right to a subcontract (sub-
ject to certain conditions); in the case at bar Gemini was at the best deprived of a contractually guaranteed right to exclude others from negotiating with AmeriPark.

Id. at 51. While the First Circuit did not discuss the holdings in the Columbia Park and Pharmathene decisions, the decision follows the same analysis expressed by the dissenting judge in Columbia Park. Objecting to the availability of expectation damages in precontractual liability cases at all because, in his view, such losses generally cannot usually be proved with a requisite degree of certainty, Judge Korsmo there argued for a complete bar on awards of lost opportunity damages in all these types of cases. Id. at 84. One of his most penetrating criticisms was a policy one based on how the decision could serve as a potential disincentive to the open negotiation of the very interim agreements that have led to the development of this new strand of precontractual liability:

Modern practices often require [complex business] transactions to be accomplished in stages while the parties learn more about each other and the nature of the transaction. Changes in market demand and financing requirements may require adjustments in negotiating stances … Because of developing information, it is easy to see that a party may want to change its position or even decline to continue negotiating … In this circumstance, allowing expectation damages might well undercut usage of agreements to negotiate because a party that is not required to come to an agreement still can be faulted for not doing so.

Id. at 96–97.

While such sentiments may not be baseless, neither the First Circuit’s decision in Gemini Investors nor Judge Korsmo’s dissent in Columbia Park adequately address why the breach of a promise not to negotiate with other parties that is designed to ensure that a commercial contract will be reached should not bring about the same award as a breach of the expected ultimate contract, subject to an appropriate discount for the likelihood that other factors might thwart achieving a final contract, the approach advanced by Professor Farnsworth.

Conclusion

The law will continue to develop in this area. Many jurisdictions have yet to confront directly how liability doctrines apply when a letter of intent does not establish that the parties reached a final agreement. The courts still need to decide how to handle proof, including which party should bear the burden of proving that the recovery can or cannot be predicted with sufficient certainty to justify an award of expectation damages. At a minimum, practitioners should remember that a party may have the opportunity to seek recovery on a lost opportunity theory. And it seems likely that plaintiffs alleging lost opportunity will use experts increasingly to establish the values of different types of lost business opportunities. An expert would need to be able to identify the legitimate obstacles that would have kept the parties from reaching a final deal and explain how despite those uncertainties a plaintiff still could claim that it suffered a loss due to a viable business opportunity. Practitioners defending clients against such claims will need to make the legal argument that legal principles should not make such a recovery available as a matter of law but also identify all the factual uncertainties that should bear on calculating an award based on an “expectation” or “lost opportunity” theory as well. The level of certainty required to prove that a business opportunity was viable and the ability of the parties to meet or defeat that burden will continue to be extremely important.