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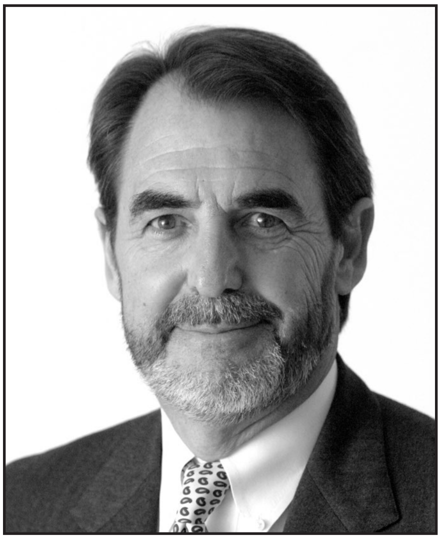

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OOPS. YOUR TERM SHEET IS A CONTRACT.

Introduction

Technology and M&A lawyers feel pretty confident about drafting term sheets and letters of intent (LOI), but a few recent cases might startle those lawyers enough to have them scramble for a copy of *Restatement (Second) of Contracts*. Permit me to provide some practice pointers about term sheets arising from these cases.[1]

In *SIGA v. PharmAthene*, the Delaware Supreme Court found that an agreement had been reached regarding a letter of intent. However, the 9th Circuit in *Atlantique v. Ion Media* held that a term sheet did not rise to an agreement.[2] In both cases, the opinions rested not only on analyzing the language but also on related documents—*e.g.*, a license agreement in the *SIGA* case and email exchanges in the *Ion* case.[3]

In many ways the *SIGA* outcome was not too surprising, given that the muddied waters of LOIs themselves make the task of discerning the intent of the parties arduous. In the *Ion* case, the court relied heavily on the email exchange between the parties in which the "protocol" for signing the term sheet was made clear. As that protocol was not followed, no agreement was formed. What's interesting—and scary—is that the negative inference would mean that the term sheet would have formed a contract *if* the parties *had* followed that protocol.[4]

Binding/Non-binding is Not a Binary Choice

As a general rule, most lawyers assume there is a binary choice: Is the document binding or non-binding? Many lawyers then conclude that a disclaimer is sufficient protection—*e.g.,* "This document is non-binding and for guidance only." (We usually see documents that do not even include *that* simple statement.) And that is the end of that.

Sadly, not so. Term sheets, even with a disclaimer, often do not follow the explicit choice. They will include provisions that are pretty clearly intended to be obligations—such as non-disclosure and "no shop" clauses along with other provisions that should be *non-binding*. Term sheets sometimes include choice of law and venue. They'll include "obligation" language such as "shall" and "will." Muddy waters indeed.

Term Sheets as Roadmaps in "Relationship" Negotiations

Term sheets are most useful in negotiating certain "relationship" agreements and venture investments—*i.e.,* deals in which the negotiations are either for a commercial relationship such as a technology license, distribution or strategic alliance or a stock purchase and investment. In other contexts, such as complicated M&A transactions, a LOI may be more suitable because of the complexity.

Our default position is that term sheets should be non-binding. Completely non-binding. *A term sheet serves as a roadmap for the lawyers to draft the definitive agreement.* Starting with that position, one can add the clear disclaimer (in big bold print). One approach is a disclaimer something to the effect of:

> The terms included in this term sheet are for guidance only in discussions to complete a definitive agreement that will be binding only once both parties have signed such agreement and expressly stated their intentions to be bound by such definitive agreement. Neither party is obligated to enter into a definitive agreement. Until such an agreement is thusly signed, each party shall be free, without liability, to change the terms and suspend or terminate negotiations.

An alternative is to add language to the effect that the terms are subject to due diligence and the situation of the parties at the time of the execution of the definitive agreement.[5]

The Binding Parts

Parties often want some obligations for each party. Those obligations are put in formal agreements, such as a non-disclosure agreement that are signed by both parties. As for "no shop" or exclusive negotiations, if the client is, for example, providing technology (*i.e.,* as a licensor or vendor), then one approach is to dissuade the parties from such limitations or reducing the exclusive period to a shorter period, say, thirty days. This approach is not viable in the venture investment context because the exclusivity is an essential element. In that case, the exclusivity obligation goes into a separate agreement.[6]

Here we get into a few thornier issues. First, making a term sheet non-binding means that *neither* party is bound by the term sheet. True, they would be bound by the formal agreements (non-disclosure, etc.) but that might not be enough. Second, in many jurisdictions the implied covenant of good faith and fair dealing applies only once an agreement has been formed. The default position would preclude its application. In such scenarios, one approach is to create a formal agreement and attach the term sheet as an exhibit, but making clear that it is for guidance only and its terms are subject to change. Conditions for change can be unstated or narrowed (*e.g.,* due diligence). Depending on the context, both parties would be bound to negotiate in good faith (because an agreement has been formed), while preserving the non-binding nature of the terms the parties want non-binding.[7]

So, depending on the choices made above, the parties could get what they want:

- Binding provisions in formal agreements drafted with the subject in mind (*e.g.,* non-disclosure);
- The non-binding roadmap of the terms in the term sheet;
- Formal agreement that the terms of the term sheet are not binding; and
- Binding obligations as to good faith and fair dealing

Details, Details, Details

It is apparent that courts will look at whether or not the language used implies obligations, *e.g.,* "shall" and "will." This issue is problematic. Documents pretty much depend on verbs but verbs catch the attention of judges. As a practical (grammatical?) matter, some provisions in a term sheet can be drafted with normative (conditional/subjunctive) language, *i.e.,* "should" or "the parties expect" or "pricing set forth in this term sheet might change based on features selected, number of seats, and feature availability." That approach might be acceptable in, say, a technology license term sheet but not so much when it comes to a venture investment in a startup: The parties want to know the number of shares and the price. In that case, fall back to specifying the conditions for change (*e.g.,* "subject to due diligence" and performance of the startup during the negotiations period).

Many commentators argue that a term sheet should *not* include a lot of detail, thus adding substance to the argument for its non-binding nature. Certain terms should be excluded or stated in ambiguous terms. For example, I often see something like: Indemnification: Industry standard.

While I see their point, I disagree. This approach would limit the effectiveness of a term sheet as a roadmap. The more detail the better. Moreover, getting the detail out in term sheet negotiations means that the parties will smoke out the sensitive issues. *If* the other steps suggested above are followed, then the additional detail should only incrementally increase risks.

Turning My Hair White

Of the many phrases I hear from clients that turn my hair white, several come to mind in the context of term sheets:

> "While you're negotiating the term sheet with their lawyer we've started to install the technology."

or the converse:

> "Our client's software engineers have been here for the last week working with our CTO on new software."

or, worse:

> "I just got an email that our client has devoted its entire tech team for the last month to configure their platform to integrate with what we're licensing."

A technical term: Yikes! Can you say "detrimental reliance?"[8] Solutions (so called) are a bit complicated. First, make it crystal clear to your client *before* negotiations occur that no such work should occur—especially installation work or technical collaboration. One of the first emails from your client to its current/prospective client in the discussions that lead to (or start) negotiations should make this statement in the clearest language possible. If there is a binding agreement among the relevant documents, then include a disclaimer of liability for any such work. If no such agreement exists, include language that each party is responsible for all costs related to any work it has performed.

Emails Matter

If *Ion* stands for anything it is to re-affirm the lesson of the last couple of decades that emails matter—in that case specifying the "protocol" for signing the relevant term sheet. This is a good idea. And it is a better idea to make it clear in that email (and without sounding ridiculous, as many emails as possible) the extent of the binding/non-binding nature of the term sheet (and related documents). It is also good legal practice hygiene to send the same type of email to the opposing attorney often.

Equally important, try to get your client to avoid ever writing an email that says "OK, we agree on xyz point." This exercise might be tantamount to proverbial cat herding, but try to impose email hygiene on your client, too. She can write something like "I see your point" or "Good point" and then follow it with something to the effect of "Let's see how it looks once it is drafted."

Caveats

Every lawyer has probably said "It depends." Well, drafting a term sheet that is to be understood to be binding or non-binding depends, too, and in this case, on the context, such as the type of transaction (a commercial relationship v. an acquisition), the industry (*pace,* Hollywood), etc. Perhaps most important is market power: A venture capitalist would laugh a lawyer out of the conference room for making many of the suggestions above. But pay attention to what goes between your client and the other party, at least enough to feel somewhat confident that the existence of a contract conforms to what your client wants.

The views expressed in this article are personal to the author and do not necessarily reflect the views of the author's firm, the State Bar of California, or any colleagues, organization, or client.

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Endnotes

1. Earlier this year the 7th Circuit issued an opinion about the failure of a contract to be formed with an "I accept" button for acceptance of Terms of Use on a website. *Sgouros v. Transunion Corp.*, No. 15-1371 (7th Cir. Mar. 25, 2016). In my view, it's an important decision for the digital world for many reasons. Among them, the opinion suggests that some additional elements that might have formed a contract. It serves as powerful guidance for lawyers drafting Terms of Use. Obviously, it is a little off point for a column on term sheets.
2. The *SIGA* case is a long-running dispute. Start with the following and work backwards: *SIGA Technologies, Inc. v. Pharmathene, Inc.*, No. 20, 2015 (Del. Dec. 23, 2015). See also the earlier substantive decision, *SIGA Technologies, Inc. v. PharmAthene, Inc.*, 67 A.3d 330 (Del. 2013). For the 9th Circuit case, Atlantique Productions, SA V. Ion Media Networks, Inc., No. 14-55326 (9th Cir. Mar. 18, 2016).
3. For the sake of space, I will not discuss the facts of each case.
4. I would suggest that the negative inference—that the term sheet *could* end up being a contract if the protocol had been followed—is typical in the entertainment industry. They seem willing to strike deals on the flimsiest of documents. This does not comfort me.
5. One can correctly infer from this language that the parties go directly from the term sheet to the definitive agreement, skipping the LOI in the context described.
6. Before my inbox is bombarded with emails accusing me of being naïve or just plain stupid, please note that this is the *default* position. In the venture context, the startup receiving the funding pretty much has to accept the term sheet as is.
7. Yes, we could discuss at length whether or not there is an issue of an "agreement to agree."
8. Let's not get into the discussion of other bases for liability, such as detrimental reliance.

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29. *Id.*, 977 F.2d at 1520.
30. *See id.* at 1522–23; *Oracle America, Inc. v. Google Inc.*, 750 F. 3d 1339, 1369 (Fed. Cir. 2014) (describing the *Sega* decision).
31. *Sony Computer Entertainment*, 203 F.3d at 598.
32. *Id.*
33. *Kelly v. Arriba Soft Corp.*, 336 F. 3d 811, 818 (9th Cir. 2003).
34. *Id.* at 818.
35. *Id.*
36. *See* 508 F. 3d 1146, 1154–55, 1176–77 (9th Cir. 2007).
37. *Id.* at 1167.
38. *Authors Guild v. Google, Inc.*, 804 F. 3d 202, 207 (2nd Cir. 2015); *Authors Guild, Inc. v. Google Inc.*, 954 F. Supp. 2d 282, 284 (S.D.N.Y. 2013).
39. Petition for a *Writ of Certiorari* at 14, *The Authors Guild*.
40. *Id.* (quoting *Campbell*, 510 U.S. at 579).
41. U.S. Const. art. I, § 8.
42. 17 U.S.C. § 107.
43. *Campbell*, 510 U.S. at at 575–76 (quoting *Carey v. Kearsley*, 4 Esp. at 170, 170 Eng. Rep. at 681)(emphasis added).
44. Petition for a *Writ of Certiorari* at 14, *The Authors Guild*.
45. Br. in Opp'n to Petition for a *Writ of Certiorari* at 3, *The Authors Guild v. Google, Inc.*, No. 15-849 (U.S. Sup. Ct. Mar. 2016)(internal citation omitted).
46. *Id.* at 8.
47. *Id.*
48. *Authors Guild*, 804 F. 3d at 222.
49. *Fox News Network, LLC v. TVEyes, Inc.*, No. 1:13-cv-05315, Op. and Order at 1 (S.D.N.Y Aug, 25, 2015).
50. *Id.* at 2.
51. *Id.* at 8.
52. *Id.* at 18.
53. *See White v. West Publishing Corp.*, No. 1:12-cv-01340, Mem. and Order at 4-8 (S.D.N.Y. July 3, 2014).
54. *Id.* at 8.
55. 17 U.S.C. § 107.