

Does North Carolina Now Recognize An Obligation to 'Negotiate in Good Faith?'

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Last summer's decision by the North Carolina Business Court ("Business Court") in RREF BB Acquisitions LLC v. MAS Properties, LLC et al. (June 9, 2015) serves as a warning to North Carolinians of a potential legally enforceable duty to act in "good faith" and engage in "fair dealing" during settlement negotiations. In that case, the Business Court recognized a potential claim brought by borrowers against their bank ("Bank") for an alleged breach of a duty to negotiate in good faith. This is the first time such a claim has been recognized by a North Carolina court and many issues remain unclear, including the extent of damages, if any, that an aggrieved party may be entitled to recover. The decision is not binding precedent on any other North Carolina court, but the opinions of the Business Court, which is a special Superior Court with statewide jurisdiction that serves as the trial court in complex business cases, are closely followed by North Carolina legal practitioners and are often considered persuasive by state and federal courts when applying North Carolina law.

The dispute in RREF BB Acquisitions, LLC arose from negotiations related to two commercial loans that were in default. Both loans were originally made for short-term repayment, but were extended, modified, or renewed by the parties on an almost annual basis over a period of many years. In 2012, the Bank learned of a lawsuit filed by another lender against the borrowers. Because of that lawsuit, the Bank did not renew the loans in 2012. Instead, following maturity of the loans, the Bank asked the borrowers to sign a forbearance agreement and it sent the borrowers certain notices which reserved the Bank's legal rights following default. The borrowers never signed a forbearance agreement as requested.

At the same time the Bank attempted to obtain the forbearance agreement, it also began marketing the loans for sale to third parties. The Bank did not tell the borrowers that it was trying to sell the loans. Instead, it simply continued to engage in settlement negotiations while the loans were being marketed for sale. After months of negotiating, the parties met and discussed potential terms for restructuring the loans. Although no final settlement was reached that day, the parties did generally agree on several terms for restructuring the loans. A few days later, the Bank's attorney sent the borrowers a "term sheet" that outlined the Bank's understanding of their discussions. That term sheet contained a disclaimer that it was intended only to "facilitate discussion" between the parties and did not constitute a commitment by the Bank to agree to any terms. It also did not indicate that it was the Bank's "best and final" settlement offer to the borrowers. In

other words, it apparently left open the possibility of additional settlement discussions.

Several weeks later, the borrowers sent the Bank a revised version of that term sheet containing their own key revisions, including the removal of a guarantor and a change in the borrowers' obligation to renew a building permit from an outright obligation to an obligation only to use the borrowers' "best efforts" to get the permit renewed. Although the Bank received the revised term sheet, it never responded to the borrowers' counter-proposal. Instead, the Bank went "dark" and ceased all communications with the borrowers. Shortly thereafter, the loans were sold by the Bank to RREF BB Acquisitions, LLC, who commenced to declare the loan in default and seek enforcement.

In support of their claim for breach of the duty to negotiate in good faith, the borrowers argued that the parties' pre-sale negotiations resulted in a mutual understanding on a sufficient number of restructuring terms to constitute a binding preliminary agreement that required the Bank to continue negotiating in good faith. Specifically, the borrowers claimed that the Bank breached its duty to negotiate in good faith by (i) failing to inform them that the Bank's term sheet was its best and final settlement offer and (ii) failing to communicate with the borrowers after the submission of their revised term sheet, even if only to reject it. Although the borrowers conceded that no such claim has ever been recognized under North Carolina law, they urged the Business Court to do so based upon the unique facts and circumstances of this case.

Ultimately, the Business Court agreed with the borrowers and held that a viable claim may exist against the Bank for breach of a duty to negotiate in good faith. Because North Carolina law already implies a duty of good faith and fair dealing in every contract, the Business Court concluded that there is no reason to deny enforceability of *an agreement to continue negotiating in good faith* provided that the agreement itself meets all of the requirements for contract formation under North Carolina law.

In explaining its rationale, the Business Court stated that, although an agreement to continue negotiating would not bind the parties to the terms of a final settlement, it would carry with it an implied obligation that the parties will continue to negotiate the terms of their settlement in good faith. In short, the Business Court deemed it possible for a jury to conclude that the Bank's actions were not "fair dealing" or in "good faith" given the parties' history, the Bank's participation in extended settlement negotiations, the Bank's failure to clearly indicate that it had ceased settlement discussions, and the Bank's marketing and sale of the loans with no notice to the borrowers until the sale had concluded.

The [RREF BB Acquisitions LLC](#) decision should cause concern for parties in North Carolina, whether individuals or businesses, who participate in pre-litigation settlement discussions to resolve a legal claim – especially financial institutions working to resolve a defaulted or matured loan. There is no timetable for the North Carolina appellate courts' consideration, and ultimately binding determination, of the viability of the Business Court's decision. Until then, parties to settlement discussions should make the parameters of their negotiation clear from the outset. For example, it may be a best practice to have the parties sign a pre-negotiation agreement that clearly reserves the right to terminate settlement discussions, without notice, at any time and for any reason or require that a party give specific notice that an offer is "final" and that there will be no further negotiations. At a minimum, take appropriate steps during all phases of negotiations to respond in some manner to the opposing parties' settlement proposals and, if you so choose, to clearly indicate your intent to end the negotiations. If not, you may find yourself defending claims that your client breached an obligation to continue settlement negotiations in good faith.

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