masuda funai

News & Types: Corporate, Finance & Acquisitions Update

Despite (or Because of) Extensive Negotiations, No Contract and No Promissory Estoppel

7/11/2016

Practices: Corporate, Finance & Acquisitions, Litigation

A common scenario involves two parties involved in intense and prolonged negotiations that one party feels resulted in an enforceable contract, but the other party does not. One of the most notorious examples of this scenario was the acquisition of Getty Oil by Pennzoil in the mid-1980s, thwarted by a competing offer from Texaco. Pennzoil claimed, and convinced a Texas jury, that it had a valid contract with Getty Oil with which Texaco had improperly interfered. This resulted in a claim by Pennzoil against Texaco for interference with contract, a multi-billion dollar jury verdict against Texaco, and eventually Texaco's bankruptcy.

The 7th Circuit Court of Appeals had to decide a similar situation in which the parties disagreed as to whether there was even a contract. (*C.G. Schmidt, Inc. v. Permasteelisa North America,* 7th Circuit Court of Appeals, No. 15-3617, June 16, 2016) Of course, the obvious question is whether there is a document with both parties' signature. But, as Judge Flaum of the 7th Circuit makes clear in his opinion, this is not always definitive.

C.G. Schmidt, Inc. (CGS) was a general contractor managing part of the construction of an 18-story office building in downtown Milwaukee for $52 million. It commenced negotiations with Permasteelisa North America (PNA) to supply a custom glass curtainwall, described by the court as a non-structural outer covering for weatherproofing and aesthetics and a substantial part of the project. CGS won the bid for the building relying on PNA's bid. But PNA backed out. CGS claimed that it had an agreement with PNA for the curtainwall and relied on PNA's Subcontract when it submitted the bid. CGS sued PNA for breach of contract and promissory estoppel.

Clearly, there was no formal written contract with both CGS's and PNA's signature. Did this prevent CGS from prevailing? The answer is no. In the end, CGS did not prevail, but it raised some arguments that Judge Flaum felt required extensive discussion. Below is a timeline of events leading to the lawsuit.

- April, 2013 – CGS solicited bids for the curtainwall. The solicitation included a contract manual and a blank sample of CGS's standard subcontract. The manual required the bidder to "accept all terms of" CGS's standard subcontract.
- April 19, 2013 – PNA submitted a bid to contract and install the curtainwall for approximately $12.7 million. The bid price included a base price, pricing schedule and alternate pricing.

- Around June, 2013 – CGS selected PNA as its "contractor of choice." But no formal subcontract was possible, as CGS had not yet made two essential contracts with the owner, a prime contract and a Guaranteed Maximum Pricing Amendment (GMPA) that fixed the project's overall budget.
- From June, 2013 to June, 2014 – CGS and PNA frequently communicated. PNA updated the proposed contract price with CGS and raised concerns with some of the terms. In September 2013, PNA requested a production schedule from CGS so PNA could confirm a time slot with its manufacturing facility in Thailand.
- February 25, 2014 – CGS sent PNA an unsigned letter of intent, including an integration clause: "Upon execution of the Subcontract agreement [between CGS and PNA], the Subcontract and its Exhibits shall supersede in all respects prior negotiations . . . including this letter of intent." PNA sent its own proposed schedule stating that it would not circulate shop drawings without an executed contract. PNA never produced shop drawings.
- March 24, 2014 – CGS and PNA participated in a "kick-off" meeting. PNA admitted that its policy is not to participate in kick-off meetings unless it is under contract.
- April 21, 2014 – CGS and the owner executed the prime contract, a condition to concluding the subcontract between CGS and PNA.
- May 16, 2014 – PNA sent CGS an updated bid price listing a "total bid price" of $8,472,995.
- May 21, 2014 – PNA requested a second letter of intent. CGS responded with a signed letter of intent with the same basic terms as the previous letter of intent on February 25, but it added four alternate materials and pushed back deadlines.
- May 27, 2014 – CGS entered into the Guaranteed Maximum Pricing Amendment with the owner, relying on PNA's May 16th total bid price.
- May 29, 2014 – PNA submitted an updated bid proposal with a "total bid price" of $8,472,995, the same as the total bid price of May 16. (Confusingly, the parties used both "total contract price", which included the price of alternates, and a "total bid price." So the bid amounts were not always comparable. But the key point is that no amount was ever agreed between CGS and PNA.)
- June 5, 2014 – CGS sent PNA a revised draft of the project scope with a total contract price of $7.8 million.
- June 13, 2014 – CGS sent PNA a proposed subcontract for a slightly lower price than the June 5 draft.
- June 16, 2014 – CGS sent PNA a second proposed subcontract with a price of $7,751,916.

Shortly thereafter, PNA abruptly "disengaged" from the project, citing civil unrest in Thailand, where the products would be manufactured.

In December 2014, CGS filed a lawsuit against PNA claiming breach of contract and promissory estoppel. The district court granted summary judgment for PNA on both claims. The 7th Circuit, in an opinion written by Judge Flaum, agreed.

Breach of Contract Claim

The breach of contract claim seemed simple enough. There was no document with both parties' signatures that purported to be an agreement. But the issue was to be decided under Wisconsin's version of the Uniform Commercial Code. UCC Section 2-204 makes clear that a contract does not have to be an integrated agreement: "A contract for sale of goods may be made in any manner sufficient to show agreement, including

conduct by both parties which recognizes the existence of such a contract." UCC Section 2-204 even permits some of the terms to be left open.

So the fact that there was no integrated agreement did not defeat CGS's breach of contract claim. Rather, the question was whether there was ever an intent to create a contract. Citing the facts noted above, Judge Flaum agreed with the district court that the parties never showed an intent to be bound. The letters of intent reinforced this conclusion, both of which explicitly stated the parties' ultimate goal of signing a Subcontract agreement, and not having a contract until that time.

Promissory Estoppel Claim

Judge Flaum called the promissory estoppel claim "the more difficult question." Under Wisconsin law, promissory estoppel is based on a) a promise that the promisor should reasonably expect to induce action or forbearance; b) action or forbearance actually induced by the promise; and c) injustice that can only be avoided by enforcing the promise.

Judge Flaum recognized CGS's dilemma, common in construction contract cases. CGS needed a binding commitment from PNA to submit a bid to the owner. But CGS could not enter into a Subcontract with PNA until the owner had agreed to CGS's bid. Judge Flaum cited Wisconsin cases (and could have cited similar cases from other states) that enforced a promise by a subcontractor on which a prime contractor relied to make a bid for a construction contract.

But there is another line of cases in which "a general [prime] contractor attempts to renegotiate the subcontractor's bid, a practice known as ‘bid chiseling'." A prime contractor cannot reopen the bidding with subcontractors after the prime contract has been awarded. This would put the prime contractor in a no-lose position – able to "chisel" down the subcontractor's bid, knowing that, at worst, the subcontractor was bound by its original bid. A prime contractor that reopens bidding may be denied promissory estoppel.

So CGS's claim for promissory estoppel failed. Judge Flaum cited the point at which CGS entered into the Guaranteed Maximum Pricing Agreement (GMPA) on May 27, 2014. We can see that the GMPA was based on PNA's May 16th "total bid price." But the events after May 27, 2014 may have been the downfall of CGS's claim. On May 29, June 5, June 13, and June 16, the parties exchanged prices. Actually, this dialog was initiated by PNA on May 29. Perhaps not knowing the implications, CGS continued negotiations with PNA on the price, notably offering a lower price each time. So, to Judge Flaum, this showed that CGS did not accept PNA's May 16th bid that CGS relied on in concluding the GMPA with the owner. Rather, CGS continued to negotiate. It even submitted Subcontracts on June 5, June 13 and June 16 to PNA with progressively lower prices. Although not made explicit by Judge Flaum, it is likely these further proposals knocked out CGS's promissory estoppel claim and put its claim in the category of "bid chiseling."

"Bid chiseling" has a negative connotation of someone trying to be hard-nosed and not completely ethical. On the other hand, it is quite possible that CGS acted throughout with good intentions and simply followed in the flow of negotiating with PNA assuming that, at some point, they would reach a deal. If so, CGS's error was not in being hard-nosed, unethical or stingy, but in not understanding the legal implications of continuing to negotiate, and especially of changing pricing, after its GMPA had been accepted by the owner.

Concluded Judge Flaum,

> "Applying promissory estoppel to this case would essentially give CGS an option contract on PNA's bid that it did not bargain for. Correspondingly, it would put PNA at the mercy of CGS's superior bargaining position. In other words, it would "transform these complex negotiations into a 'no lose' situation" for CGS. In complex negotiations between sophisticated parties, it is preferable to leave the losses where they fall, rather than enforcing preliminary negotiation positions wrought with contingencies and uncertainty."

Sadly for CGS, either because of its greed or the failure to appreciate the legal implications of further negotiation, the loss in this case fell on CGS.