IN THE SUPREME COURT OF THE STATE OF DELAWARE

GLAXO GROUP LIMITED and HUMAN GENOME SCIENCES, INC.	)	
Defendants Below, Appellants,	)	**No.** 25, 2020.
v.	)	On Appeal from the Superior Court of the State of Delaware
DRIT LP,	)	C.A. No. N16C-07-218
Plaintiff Below, Appellee.	)	

BRIEF OF WASHINGTON LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF APPELLANTS AND REVERSAL

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STATEMENT OF IDENTITY OF *AMICUS CURIAE*, ITS INTEREST IN THE CASE, AND THE SOURCE OF ITS AUTHORITY TO FILE

Washington Legal Foundation is a nonprofit, public-interest law firm and policy center with supporters nationwide. WLF promotes free enterprise, individual rights, limited government, and the rule of law. It appears often as an *amicus curiae*, in state courts across the country, to promote these values. See, e.g., *Frlekin v. Apple*, 457 P.3d 526 (Cal. 2020); *Burningham v. Wright Med. Group*, 448 P.3d 1283 (Utah 2019); *Delisle v. Crane Co.*, 258 So. 3d 1219 (Fla. 2018).

Businesses "crave certainty as much as almost anything: certainty is what allows them to make long-term plans and long-term investments." Alan Greenspan & Adrian Wooldridge, *Capitalism in America: A History* 258 (2018). The need for that certainty is at the heart of this case. Companies draft contracts in the expectation that they will be enforced as written. When courts and juries graft new terms onto those contracts, based on their own assumptions and speculations about what the contracting parties "might" have "really" wanted, businesses lose the certainty they so desperately need, and the economy as a whole suffers. WLF urges the Court to make clear how rarely (if ever) sophisticated parties should be held to—and thus penalized when they fail to foresee and obey—*post hoc* contract terms created in a courtroom.

INTRODUCTION AND SUMMARY OF ARGUMENT

The implied covenant of good faith and fair dealing often puzzles judges and scholars. This is unfortunate. No one (besides lawyers) benefits from doctrinal confusion. What are parties negotiating a contract to make, for example, of a legal authority that in one sentence says they each must act "reasonably," and that in the very next says they each will be "entitled to enforce the terms of the contract to the letter"? *N. Trust Co. v. VIII S. Mich. Assocs.*, 657 N.E.2d 1095, 1104 (Ill. App. Ct. 1995).

Much of the discussion of the implied covenant in Delaware is eminently sound. "Existing contract terms control." *Lonergan v. EPE Holdings, LLC*, 5 A.3d 1008, 1017 (Del. Ch. 2010). Yes. "Absent grounds for reformation," courts "should not rewrite contracts." *Nemec v. Shrader*, 991 A.2d 1120, 1128 n.28 (Del. 2010). Indeed. The implied covenant "only applies to developments that could not be anticipated." *Id*. at 1126. Just so. But this State's courts sometimes frame the doctrine more broadly. They occasionally say that the implied covenant empowers them to create and enforce hypothetical contracts; to give the parties what they "likely would have agreed to" had "they thought to negotiate with respect to [a] matter." *Lonergan*, 5 A.3d at 1018.

The implied covenant is supposed to help parties enforce their bargains. To fulfill that task, the implied covenant must be well defined, narrow, and clear. To

the extent that it treats the implied covenant as "the enforcement of [a] counterfactual contract," however, "Delaware . . . ha[s] adopted" a standard that is in tension "with the basic principles of contract law" and that "threatens the bargains reached by contract parties." Daniel B. Listwa, *Cooperative Covenants: Good Faith for the Alternative Entity*, 24 Stan. J.L. Bus. & Fin. 137, 156-57 (2019). As the explosion of litigation over the implied covenant shows—"in 2017 alone," this Court "issued seven opinions" on the topic, *id*. at 141—reaching too often for hypothetical contract terms has serious adverse effects. The implied covenant has become catnip for "plaintiffs' lawyers" hoping "to capture value from the uncertainty that persists in this area." *Id*. Now is a good time to heed the words of Learned Hand: "In commercial transactions it does not in the end promote justice to seek strained interpretations in aid of those who do not protect themselves." *James Baird Co. v. Gimbel Bros., Inc.*, 64 F.2d 344, 346 (2d Cir. 1933).

I. We agree with the appellants that, viewed from any angle, the trial court and the jury misapplied the implied covenant. They erred in favoring a hypothetical agreement over the parties' actual agreement, and they erred in forming that hypothetical agreement around what just *one* of the contracting parties might have wanted.

II. We urge the Court not to let the implied covenant drift too far from the text of the contract. Especially where, as here, the contract at issue is an agreement between sophisticated companies, a court's core assumption should be that parties can, and may be expected to, negotiate for what they want and then write it down. This assumption is part of this State's implied-covenant jurisprudence, and it is at the heart of many other States' version of the implied covenant. When a contract is not adhesive, the implied covenant should usually serve merely to block a party from manipulating for advantage in the face of a *truly* unforeseeable event.

Holding parties closely to their written agreements keeps the courts out of the business of trying to "fix" contracts, something they cannot possibly do well. It also discourages implied-covenant litigation. Above all, it benefits the contracting parties, by encouraging them to get their contracts right the first time. In the end, after all, only they can draft clear, thorough, workable contracts.

"If parties wish more certainty," Hand wrote, "they must use more certain words." *Eustis Mining Co. v. Beer, Sondheimer & Co.*, 239 F. 976, 986 (S.D.N.Y. 1917). Right again.

ARGUMENT

I. THE TRIAL COURT AND JURY MISAPPLIED THIS COURT'S IMPLIED-COVENANT TEST.

In the next section we will discuss the dangers of using counterfactuals about what contracting parties "would have" agreed to. First, however, a word on

how the trial court and jury misapplied even the most expansive possible version of this State's implied covenant.

The implied covenant is sometimes described in Delaware as enabling a factfinder to declare the violation of a hypothetical contract term the parties "likely would have agreed to" had "they thought to negotiate with respect to that matter." *Lonergan*, 5 A.3d at 1018. The better view—also to be found in this State's jurisprudence—is that "the implied covenant only applies to developments that could not be anticipated, not developments that the parties simply failed to consider." *Nemec*, 991 A.2d at 1126. But in any event, the contracting parties here *did* "th[ink] to negotiate" about the matter in question. They signed a contract that explicitly provides for the possibility that a patent will be "disclaimed." (See GSK Br. Ex. A (MSJ Op.) at 5.) Having raised the possibility of patent disclaimer, the contracting parties *could* have gone a step further and placed conditions on *when* a patent could be disclaimed. That the parties placed no limits on disclaimer, despite being *aware of the issue of disclaimer*, should have been all the trial court needed to dismiss the implied-covenant claim. Yet it didn't.

After improperly letting the implied-covenant claim proceed beyond the pleading stage, the trial court compounded its error by letting a jury read a limit on disclaimer into the contract. To send the implied-covenant claim to a jury, the trial court needed to find a material dispute of fact about whether *both* contracting

parties, had they thought of an issue, would have executed a contract term addressing it. *Lonergan*, 5 A.3d at 1018. Yet here the trial court found merely that *one* of the contracting parties might have wanted a contract term limiting disclaimer. (GSK Br. Ex. A (MSJ Op.) at 20.) The court did not assess whether the appellants would have agreed to the term. The jury, in turn, implied the limit on disclaimer into the contract even though no evidence suggested that the appellants, at the time of contracting, would have accepted it. (GSK Br. Sec. I.C.2.b.)

Even applying the broadest possible version of this State's implied-covenant, the Court should still reverse the judgment.

II. THE IMPLIED COVENANT SHOULD ONLY RARELY BE USED TO IMPOSE HYPOTHETICAL CONTRACTS ON SOPHISTICATED PARTIES.

"It does not appear that there is any uniform understanding" of the implied covenant's "precise meaning." *Northwest v. Ginsberg*, 572 U.S. 273, 285 (2014). Inconsistency remains despite extensive judicial efforts to give the doctrine shape. "The attention lavished on the implied covenant has not . . . resulted in the emergence of a clear consensus on what it is." Harold Dubroff, *The Implied Covenant of Good Faith in Contract Interpretation and Gap-Filling: Reviling a Revered Relic*, 80 St. John's L. Rev. 559, 560 (2006); see also Michael P. Van Alstine, *Of Textualism, Party Autonomy, and Good Faith*, 40 Wm. & Mary L. Rev. 1223, 1227 (1999).

The persistent confusion in this area is a sign that the courts are in danger of drifting off course. During "a century of dispute," the "judiciary has pursued conflicting ends, and the result is predictable." *Humantech, Inc. v. Caterpillar, Inc.*, 2012 WL 6214371 *2 (E.D. Mich. 2012). What's needed, at least when it comes to contracts carefully constructed by sophisticated parties, is a renewed appreciation of the value of disciplined contract interpretation. Rather than trying to adjust ever more contracts to account for unforeseen events—something it is not equipped to do—the judiciary should re-focus on "reduc[ing] unforeseen events by not adjusting contracts." *Id*.

A. The Implied Covenant Generally Addresses Only Truly Unforeseeable Events.

"Well, everyone knows what we *really* meant." When a contractual deal goes sour, at least one side will always be tempted to say these words—and then to write something like them in a complaint that starts a litigation. And if courts are not disciplined about enforcing contracts as written, this temptation to sue will often be rewarded. Put in dry economic terms, unpredictable judicial behavior incentivizes a disgruntled party to generate a deadweight loss to society (litigation) in search of a false positive (a finding of breach where none occurred). Put in plain English, it gives the party good reason to try his luck; to seek a judge or a jury willing to rewrite the contract for him.

"Rewrite" is not too strong a word. Even on the rare occasion when it should apply the implied covenant, a court should be clear-eyed about what it is doing. It is *adding* something of its own to the contract. When as in Delaware it cannot be waived, the implied covenant is "a state-imposed obligation." *Ginsberg*, 572 U.S. at 286-87. It "*enlarge[s]*" the "contractual agreement." *Id*. at 289 (emphasis added). The only thing that shows beyond peradventure what *the parties* agreed to, the only thing that *is* the contract, is what is written in the contract. The contract's words contain the whole of "the parties' voluntary undertaking." *Id*. at 284.

Courts should therefore stick whenever possible to applying a contract's words, if for no other reason than to respect the parties' freedom of contract. "Contracts generate obligation not through their optimality"—not, that is, based on whether they are structured as *a court* might wish—"but through the fact that they are agreed to by the parties." Listwa, supra, at 155. Inherent in the parties' *right* to structure their own affairs is their *duty* to live with the consequences, good or bad, of their prior autonomous choices. *Nemec*, 991 A.2d at 1126 ("Parties have a right to enter into good and bad contracts[;] the law enforces both.").

What is more, adherence to contractual text *works*. It is efficient. "Contracts enable parties to define their mutual rights and responsibilities," but "they are useful only insofar as each side can count on being able to hold the other to the terms of the agreement." *Travelers Ins. Co. v. Budget Rent-A-Car Sys., Inc.*, 901

F.2d 765, 768 (9th Cir. 1990). "Unless pacts are enforced according to their terms, the institution of contract, with all the advantages private negotiation and agreement brings, is jeopardized." *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1357 (7th Cir. 1990). Any attempt to "add an overlay" of judicial policymaking to contract enforcement is sure to "reduce commercial certainty and breed costly litigation." *Id*.

Judges should usually stick to a contract's words *even if* it is sometimes true that the parties "really" wanted something those words fail to convey. *Id*. The search for the "really"-wanted is itself what "reduce[s] commercial certainty and breed[s] costly litigation." *Id*. Declining to engage in that search, meanwhile, spurs parties to ensure that what they "really" want *is* reduced to words. To return to economics-speak, "false negatives in determining that a breach has occurred are, on the whole, less damaging to economic efficiency than false positives, because false negatives make litigation less attractive . . . and encourage more specific contract drafting." Listwa, supra, at 166.

Perhaps the most important statement in all this State's implied-covenant jurisprudence is then-Vice Chancellor Strine's insistence that a court should not "grant" to "plaintiffs, by judicial fiat, contractual protections that they failed to secure for themselves at the bargaining table." *Aspen Advisors LLC v. Utd. Artists Theatre Co.*, 843 A.2d 697, 707 (Del. Ch. 2004); accord *Nemec*, 991 A.2d at 1126.

If a court wants to help parties enjoy the benefit of their contracts, the best thing it can do is to put the onus on the parties to create predictable contracts in the first place. This is especially so where, as here, the parties are sophisticated businesses well equipped to look out for their own interests. Such firms—firms "that have *negotiated* contracts"—are "entitled to enforce them to the letter, even to the great discomfort of their trading partners, without being mulcted for lack of 'good faith.'" *Kham & Nate's Shoes*, 908 F.2d at 1357 (emphasis added).

In most cases involving sophisticated entities, the implied covenant simply requires that neither side "take opportunistic advantage in a way that *could not have been contemplated* at the time of drafting." *Id*. (emphasis added). It protects each side from manipulative behavior that it not only did not, but *could not*, have foreseen and protected itself against in advance.

B. Courts Are Not Good At Divining Hypothetical Agreements (And Many Don't Even Try).

Courts will never be good at using the implied covenant to create contract terms the parties "likely" would have wanted had they "thought" of them. *Lonergan*, 5 A.3d at 1018. A big part of the problem is that judges and juries are bound to be bad at assessing *ex post* what contracting businesses *would* have wanted *ex ante*. The problem is not just hindsight bias (though it *is* that, too). It's that judges and juries must decide what the businesses "would have" wanted after receiving only a crash course in how those businesses' industry works. And it's

that judges and juries are likely to bring to their decisions sensibilities about what counts as "fair" practice very different from those that prevail in the industry at hand. Invited to decide what the parties "would have" wanted, lay factfinders will be tempted to put the contract's terms to one side, clearing the way for them to satisfy an urge to punish standard hard-nosed business dealings. Moving away from a straightforward enforcement of the contract that *is*, and toward an unstructured meditation on the contract that *might have been*, is a recipe for second-guessing followed by error and wrongful condemnation.

Even if judges and juries were fairly good at creating the contract the parties *would* have wanted, which they're not, letting parties freely enforce such "contracts" would remain a bad idea. The world is complex, chaotic, and fundamentally unpredictable. Surprising events are inevitable, and it will often be the case that, had they foreknowledge of such events, parties would write a different contract, an improved contract, a contract better suited to the world to come. If one wanted to impose a rule that functioned as a lawsuit-generating machine, an ever-reliable source of billable hours for lawyers, one could hardly do better than to declare that parties have recourse to the court every time a contract could, with perfect knowledge of the future, have been made better. A "counterfactual test" that "identifies a breach of the implied covenant in *every case*

in which the hypothetical bargain would differ from the actual contract" will "locate[] breaches in far too many cases." Listwa, supra, at 166.

Given the problems that come with the judicial game of trying to divine counterfactual contracts, it is no surprise that many courts apply a contract's words whenever they apply, regardless of how circumstances may, in the plaintiff's view, have unexpectedly changed. See, e.g., *Bevis v. Terrace View Partners, LP*, 33 Cal. App. 5th 230, 252 (Cal. Ct. App. 2019) ("[The] covenant . . . cannot contradict the express terms of a contract."); *Nine Twenty, LLC v. Bank of the Ozarks*, 786 S.E.2d 555, 558 (Ga. Ct. App. 2016) (the implied covenant cannot bar a party from doing what "the contract expressly give[s] him the right to do"); *Ahearn v. Mayo Clinic*, 180 So. 3d 165, 170 (Fla. Dist. Ct. App. 2015) (the implied covenant is not "a source of breach when all other [contract] terms have been performed"); *Blondell v. Littlepage*, 991 A.2d 80, 90 (Md. 2010) ("[The covenant simply] requires that one party to a contract not frustrate the other party's performance."); *Shoney's LLC v. MAC East, LLC*, 27 So. 3d 1216, 1221 (Ala. 2009) (the implied covenant cannot bar a party from doing what "the contract expressly give[s] him the right to do"); *Volvo Const. Equip. N. Am., Inc. v. CLM Equip. Co., Inc.*, 386 F.3d 581, 599 (4th Cir. 2004) (South Carolina law) (the implied covenant cannot bar a party from doing what "the contract expressly give[s] him the right to do").

In many jurisdictions, in short, "where parties have addressed an issue in the contract, no occasion to divine their intent or supply implied terms arises." *Taylor Equip., Inc. v. John Deere Co.*, 98 F.3d 1028, 1032 (8th Cir. 1996). Many of these courts also recognize that sophisticated businesses, when they sign an agreement, accept the risk embodied in their contract's terms. *Cardinal Stone Co., Inc. v. Rival Mfg. Co.*, 669 F.2d 395, 396 (8th Cir. 1982). "Although that risk" might result "in economic hardship," the typical corporation "may not . . . represent itself as an untutored victim of sharp business practices." *Id*. A business "cannot be heard to complain," therefore, of its counterparty's "exercise of a right which" the business "expressly relinquished." *Id*.

This Court should make clear that implied-covenant counterfactuals are dangerous when overused. Hypotheticals should be employed only in narrow circumstances and with great care. Only thus can "wielding the implied covenant" remain the "cautious enterprise" it is supposed to be. *Lonergan*, 5 A.3d at 1018.

CONCLUSION

The judgment should be reversed.

Respectfully submitted,

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