SIGA Technologies, Inc. v. PharmAthene, Inc.: Delaware Supreme Court Finds Commitment to Negotiate in Good Faith Applies to Non-Binding Term Sheet

On May 24, 2013, the Delaware Supreme Court issued an opinion in *SIGA Technologies, Inc., v. PharmAthene, Inc.*,[1] reaffirming the rule that an obligation to negotiate in good faith according to a term sheet that stated it was non-binding can be enforceable.[2] It is common practice to outline the basic terms of a business deal in a term sheet that explicitly states that the term sheet is non-binding in order to avoid contractual obligations until a formal agreement containing all of the terms is executed. In *SIGA Technologies*, the Court determined that SIGA Technologies, Inc. ("SIGA") was acting in bad faith when it proposed terms that were substantially different from those embodied in the term sheet, despite the term sheet's inclusion of an explicit provision indicating that the term sheet was non-binding. Further, the Court provided clear direction that expectation damages could be awarded if the trial judge determines that the parties would have reached an agreement but for the defendant's breach.

I. Factual Background and Procedural History[3]

In 2005, SIGA and PharmAthene, Inc. ("PharmAthene") began discussions regarding a possible transaction. Both companies were engaged in biodefense research and development. At the time of the discussions, SIGA was involved in the development of an antiviral drug for the treatment of smallpox, ST-246, and SIGA was having difficulties obtaining investor financing for the development of the drug due to ST-246's unknown viability. In response to these immediate cash needs, SIGA and PharmAthene sought to collaborate on the further development of ST-246 after conservative estimates of the two companies valued that drug at approximately $1 billion. PharmAthene desired a merger between the two companies, but SIGA was resistant due to a previously failed attempt of the two parties to merge. SIGA proposed a license agreement that would address SIGA's short-term cash needs while still providing PharmAthene with potential for profits if the drug became successful. In January 2006, representatives of both PharmAthene and SIGA reached an agreement on a License Agreement Term Sheet ("LATS") setting forth the basic terms of the collaboration, which explicitly stated its terms were non-binding.

In March 2006, the parties entered into a letter of intent for a merger with the LATS attached. PharmAthene expressed to SIGA its desire to execute simultaneously a merger agreement and a license agreement that would become effective in the event that the merger was not consummated. Recognizing SIGA's immediate need for cash, the parties decided not to draft the license agreement and, ten days later, the parties entered into a Bridge Loan Agreement providing SIGA with working capital. The parties entered into a Merger Agreement in June 2006. The Bridge Loan Agreement and the Merger Agreement each contained provisions that the parties agreed to negotiate in good faith in accordance with the terms of the LATS, which was attached to both documents.

Shortly after entering into the Merger Agreement, SIGA received over $20 million in funding from the National Institutes of Health and SIGA's executives began to reconsider the benefits of a merger. In September 2006, PharmAthene requested that SIGA extend the quickly approaching drop-dead date but SIGA refused,

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[1] *SIGA Technologies, Inc., v. PharmAthene, Inc.*, No. 314, 2012 (Del. May 24, 2013), available at http://courts.delaware.gov/opinions/download.aspx?ID=189780 (the "Opinion").

[2] In this case, the term sheet outlined details related to material aspects of the agreement, including patents covered, licenses, license fees, and royalties. The term sheet was subsequently attached to two agreements that contained provisions requiring the parties to negotiate in good faith according to the terms of the non-binding term sheet. Opinion at 6, 10–11.

[3] The factual background is summarized from the background set forth in the Court's opinion.

terminating the Merger Agreement in early October. In response, PharmAthene sought to finalize a license agreement for ST-246. The companies engaged in several discussions regarding the terms of the proposed license agreement. SIGA's proposed terms were radically different from the terms of the LATS, significantly increasing upfront payments and royalties to SIGA from PharmAthene. PharmAthene insisted that the basic economic substance of the LATS should control, but SIGA disputed that the LATS was binding because of the "Non-Binding Terms" footer found within the document. In December 2006, PharmAthene filed suit in the Court of Chancery to enforce the obligation to negotiate in good faith.

Applying Delaware law, the Court of Chancery determined that SIGA was in breach of its obligation to negotiate in good faith a license agreement in accordance with the terms embodied in the LATS.[4] The Vice Chancellor found that SIGA was also liable under the doctrine of promissory estoppel and that SIGA was required to pay damages equal to an "equitable payment stream approximating the terms of the license agreement . . . ."[5] SIGA appealed the decision to the Delaware Supreme Court.

II. The Decision of the Delaware Supreme Court

On appeal, SIGA asserted that it was inconsistent to conclude that SIGA was bound to negotiate in good faith while also holding that the LATS was not a binding license agreement.[6] The Court disagreed, reaffirming that "an express contractual obligation to negotiate in good faith is binding on the contracting parties."[7]

The Delaware Supreme Court distinguished prior case law that determined a preliminary agreement to negotiate in good faith the details of a price adjustment could not be inferred to also include an agreement to conduct future negotiations in good faith.[8] In *VS & A Communications Partners, L.P. v. Palmer Broadcasting Limited Partnership*, a Chancellor applying New York law concluded that obligations to negotiate in good faith are unenforceable where material aspects of the contract remain open to negotiation.[9] In the present case, the Court emphasized that the letter of intent at issue in *VS & A Communications* did not include express provisions requiring good faith negotiations in any attempts to reach a final agreement.[10] The Court supported its conclusion by summarizing *Gillenardo v. Connor Broadcasting Delaware Co.*, which also distinguished *VS & A Communications* by highlighting the absence of explicit good faith provisions and the potential differences in New York and Delaware law.[11] Delaware law provides that the intention of the parties controls the creation of any good faith duties to negotiate under a letter of intent.[12]

The Court looked to the express contractual language in both the Bridge Loan Agreement and the Merger Agreement to determine the intent of the parties. Both documents explicitly required good faith negotiations with the intention of reaching a definitive license agreement "in accordance with the terms set forth" in the LATS.[13] The Court stated that the question at issue is whether the parties had a duty to conduct their negotiations in a

[4] Opinion at 16.
[5] Opinion at 17.
[6] Opinion at 21.
[7] *See Titan Inv. Fund II, LP v. Freedom Mortg. Corp.*, 2012 WL 1415461 (Del. Super. Mar. 27, 2012) at 6–7 (reversed on other grounds, 58 A.3d 984 (Del. 2012)).
[8] Opinion at 22–23, distinguishing *VS & A Communications Partners, L.P. v. Palmer Broad. Ltd. Partnership*, 1992 WL 339377 (Del. Ch. Nov. 16, 1992) at 7 (*"VS & A Communications"*).
[9] *VS & A Communications* at 8.
[10] Opinion at 24.
[11] *Id.*
[12] *Id.* at 25 (citing *VS & A Communications*, at 4).
[13] *Id.* at 26.

manner consistent with the economic terms embodied by the LATS.[14] The Court concluded that SIGA and PharmAthene intended to negotiate towards a "license agreement with economic terms substantially similar to the terms of the LATS if the merger was not consummated" because the LATS was incorporated into both the Bridge Loan Agreement and the Merger Agreement. The Court reached this conclusion even though the LATS was not signed and contained a footer stating "non-binding terms."[15]

SIGA argued that requiring the parties to reach an agreement with terms substantially similar to those in a term sheet would introduce uncertainty and potential litigation risks into negotiations. The Court rejected this notion, stating that, in order for such an obligation to be enforceable, Delaware law also requires an element of bad faith, i.e. "the conscious doing of a wrong."[16] The Court agreed with the decision of the Court of Chancery, finding that SIGA's proposed terms "differed dramatically" from the terms of the LATS and "virtually disregarded" the economic terms in the LATS.[17] The Court noted the evidence of seller's remorse and the conduct of the negotiations by persons who had no prior involvement in the LATS agreement as indicative of bad faith.[18] Accordingly, the Court affirmed the decision of the lower court finding that SIGA had breached its obligations under the Merger Agreement and the Bridge Loan Agreement to negotiate in good faith a license agreement.[19]

III. Expectation Damages[20]

The Court concluded its analysis by addressing the proper remedy for "breach of an agreement to negotiate in good faith where the court finds as fact that parties, had they negotiated in good faith, would have reached an agreement."[21] Acknowledging that prior decisions had failed to adequately answer this question, the Court held that if a trial judge determines that the parties would have reached an agreement but for the defendant's breach, a trial court may impose expectation damages. In support of this conclusion, the Court reasoned that expectation damages are reasonable where the factual record indicates that but for the breach, the parties would have reached an agreement. The Delaware Supreme Court ultimately remanded the matter on the issue of damages.[22]

IV. Significance of the Decision

The decision of the Delaware Supreme Court clarifies that notwithstanding that a term sheet expressly indicates it is non-binding, if there is a binding obligation that the parties will negotiate in good faith, a Delaware

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[14] *Id.* at 26.
[15] *Id.* at 27.
[16] Opinion at 28 (citation omitted).
[17] *Id.* at 27 (citation omitted).
[18] *Id.* at 29 (citation omitted).
[19] *Id.* at 29–30.

[20] Prior to examining the proper damages within the context of preliminary agreements, the Court reversed the Court of Chancery's decision finding SIGA liable under the principle of promissory estoppel. In rejecting the lower court's analysis, the Court emphasized that "promissory estoppel does not apply . . . where a fully integrated, enforceable contract governs the promise at issue." Both the Bridge Loan Agreement and the Merger Agreements expressly included promises to negotiate in good faith. Accordingly, the reliance on promissory estoppel to determine SIGA's fault was inappropriate. The Vice Chancellor is required to look directly to the contract. Opinion at 30–31.

[21] Opinion at 31.
[22] *Id.* at 38. The Court noted that it was "unclear to what extent the Vice Chancellor based his damages award upon a promissory estoppel holding rather than upon a contractual theory of liability predicated on… [the] preliminary agreement." *Id.*

Court will enforce that provision. In such a case, a party's negotiating conduct, such as proposing economic and other terms that are significantly different than those outlined in the non-binding term sheet, may be construed by a Delaware Court as a failure to negotiate in good faith and be viewed as a breach of such a commitment exposing the breaching party to potential damages. In that regard, the decision also clarifies that a trial court may award expectation damages where the parties enter into preliminary agreements addressing certain major terms, but leave other terms open for further negotiation.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Helene R. Banks at 212.701.3439 or hbanks@cahill.com; Charles A Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com.