Delaware Supreme Court Rules that Expectation Damages are an Appropriate Remedy for Breach of an Obligation to Negotiate a Term Sheet in Good Faith

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The Delaware Supreme Court recently ruled in SIGA Technologies, Inc. v. PharmAthene, Inc., No. 314, 2012, 2013 Del. LEXIS 265 (Del. May. 24, 2013), that a party may be liable for expectation damages for failing to comply with a covenant to negotiate in good faith. That is, where the facts demonstrate that (i) a party has breached its obligation to negotiate in good faith and (ii) but for that party’s bad faith, the parties would have entered into a binding agreement, the Supreme Court found that it is an appropriate remedy under Delaware law to award reasonably foreseeable damages in an amount that would put the non-breaching party in the same position it would have occupied had a binding agreement been entered into. Further, the parties in the instant case had agreed to negotiate in good faith in accordance with a term sheet, and the court concluded that the measure of reasonably foreseeable expectation damages could be based on that term sheet, notwithstanding that the term sheet purported on its face to be non-binding. The case provides a useful reminder to corporate practitioners that careful attention should be paid when drafting preliminary documents and that a binding obligation to negotiate in good faith ought to be taken seriously. Documents intended to only set forth preliminary terms should clearly disclaim any other intentions to avoid any implication of binding obligations on the parties.

Background
In late 2005, PharmAthene, Inc. ("PharmAthene") and SIGA Technologies, Inc. ("SIGA"), two biodefense companies involved in pharmaceutical development, began discussions regarding a collaboration through which they would develop and commercialize an antiviral smallpox treatment drug that SIGA had acquired in 2004. In early 2006, PharmAthene and SIGA reached agreement on a two-page license agreement term sheet (the "Term Sheet") which included, among other things, a description of the scope of the license and economic terms of license fees and royalty payments. The Term Sheet was not signed by the parties and included an express footer on each page stating that its terms were non-binding.

Following the negotiation of the Term Sheet, over the course of 2006, PharmAthene and SIGA negotiated and entered into a merger agreement whereby PharmAthene would acquire SIGA, as well as an interim bridge loan agreement to address SIGA’s immediate cash needs at the time. Both the
merger agreement and the bridge loan agreement included the Term Sheet as an attachment and obligated PharmAthene and SIGA to negotiate a definitive license agreement in good faith in accordance with the terms of the Term Sheet if the transactions contemplated by the merger agreement did not close.

During the period between execution of the merger agreement and the “drop-dead date” after which the merger agreement could be terminated, the drug at issue succeeded in passing several key milestones that increased its value. PharmAthene requested an extension of the drop-dead date prior to the merger agreement’s expiration, in response to which SIGA notified PharmAthene that it was terminating the merger agreement. Upon termination, a ninety-day exclusive negotiating period commenced, during which PharmAthene sent SIGA a proposed license agreement containing terms that in its view were consistent with the Term Sheet. SIGA responded to PharmAthene with a limited liability company agreement containing economic terms that differed significantly from those contained in the Term Sheet. PharmAthene contended that the negotiations should adhere to the basic terms of the Term Sheet, while SIGA insisted that it would only negotiate if PharmAthene abandoned its position that the Term Sheet was binding. When negotiations reached an impasse, PharmAthene filed suit against SIGA at the end of 2006 in the Delaware Court of Chancery to, among other things, enforce the obligation of SIGA to negotiate in good faith.

In its 2011 opinion, the Court of Chancery determined that under Delaware law, SIGA was in breach of its obligation to negotiate in good faith a license agreement in accordance with the terms embodied in the Term Sheet and granted PharmAthene equitable damages as well as attorneys’ fees and costs. SIGA appealed the Court of Chancery’s opinion to the Delaware Supreme Court.

**Delaware Supreme Court Decision**

The Supreme Court affirmed that Delaware courts will enforce an obligation to negotiate in good faith in accordance with the terms set forth in a term sheet, notwithstanding that the term sheet itself includes language suggesting it is non-binding. The court reasoned that it was not inconsistent to find that the Term Sheet was itself non-binding, because it was integrated within a contract that included an enforceable obligation between the parties to negotiate a license agreement on such terms.

By proposing terms that were fundamentally different from those in the Term Sheet and refusing to continue negotiations unless PharmAthene agreed to ignore the Term Sheet, the Supreme Court upheld the trial court’s factual conclusion that (i) SIGA acted in bad faith and (ii) in the absence of bad faith, the parties would have entered into a license agreement on terms consistent with the Term Sheet. Accordingly, the Supreme Court concluded as a matter of law that PharmAthene was entitled to “expectation damages” and remanded the case to the Court of Chancery to determine the amount of damages that would put PharmAthene in the same position it would have occupied had SIGA not breached its contractual obligation to negotiate in good faith.

**Practical Takeaways**

The Court’s reasoning and conclusion are instructive to corporate practitioners and their clients in several respects:

- It is not uncommon for parties to defer the resolution of certain issues – for example, to maintain momentum in a transaction or for the sake of expediency – by agreeing to negotiate in good faith to achieve a particular result or outcome. Some parties may not fully appreciate the meaningful consequences of agreeing to “negotiate in good faith” and thus
view it as a low-risk means to save time or bridge a temporary roadblock in negotiations. However, the SIGA case reinforces that courts can and do take such obligations seriously, and as a result, parties should consider the risks of this approach and carefully document terms accordingly.

- If parties agree to negotiate in good faith on certain specified terms, a court called upon to determine compliance with such obligation will evaluate the conduct of each party. Because a party may be deemed to have acted in bad faith by proposing different terms or by refusing to engage in discussions that adhere to the previously specified terms, care should be taken to establish the most favorable factual record under the given circumstances.

- Parties should tread cautiously when documenting proposed terms that are intended to be non-binding, and where applicable, should among other things disclaim any intention of creating a binding obligation. However, a trap for the unwary awaits those that couple “non-binding” terms with a binding covenant to negotiate in good faith toward an agreement on such terms. A party found to have acted in bad faith can be held liable for the parties’ collective failure to enter into an agreement that reflects the “non-binding” terms. Further, the amount of liability may be substantial – where a court determines that the parties would have entered into an agreement in accordance with the “non-binding” terms but for the breach, it may impose damages sufficient to place the non-breaching party in the same position as it would have occupied had an agreement been reached on such terms.

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Chicago lawyers:

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1 The Court described bad faith under Delaware law as “not simply bad judgment or negligence, but rather it implies the conscious doing of a wrong because of dishonest purpose or moral obliquity; it is different from the negative idea of negligence in that it contemplates a state of mind affirmatively operating with furtive design or ill will.” SIGA Techs., Inc. v. PharmAthene, Inc., No. 314, 2012, 2013 Del. LEXIS 265 (Del. May. 24, 2013) (internal quotations omitted).