

ClientAlert

Mergers & Acquisitions

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Delaware Supreme Court Confirms Liability for Failure to Negotiate in Good Faith

On appeal from the Delaware Court of Chancery, the Delaware Supreme Court, in *SIGA Technologies, Inc. v. PharmAthene, Inc.*,¹ recently held that an agreement to negotiate in good faith in accordance with a term sheet is an enforceable obligation and that the failure to negotiate in substantial conformity with the term sheet will, under certain circumstances, result in liability for expectation (or “benefit-of-the-bargain”) damages.

Although the Court’s decision should not be read in isolation from the facts of the case, any party contemplating an agreement to negotiate in good faith should be cautious of the potential implications of setting forth transaction terms in a term sheet that is attached to or referenced in such agreement.

Background

In late 2005 and early 2006, SIGA Technologies, Inc. and PharmAthene, Inc. negotiated the terms of a license agreement for SIGA’s antiviral drug for the treatment of smallpox (ST-246), a product that had “enormous potential” but which SIGA faced challenges in developing.² After the parties agreed upon a term sheet for the license agreement (“LATS”), however, the PharmAthene board decided that it would prefer a merger with SIGA over a licensing arrangement for ST-246.³ Subsequently, PharmAthene and SIGA began negotiating, and on June 8, 2006 entered into, a merger agreement.⁴ Reflecting PharmAthene’s desire to obtain ST-246 either through the merger or a license agreement, the merger agreement expressly provided that, if the merger agreement were to be terminated, then the parties would negotiate in good faith a definitive license agreement in accordance with the terms set forth in the LATS.⁵ A copy of the LATS, which was not signed by either party and included a footnote on each page that stated “Non Binding Terms,” was attached to the merger agreement as an exhibit.⁶



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¹ C.A. No. 2627 (Del. Mar. 24, 2013).

² *SIGA Tech.*, C.A. No. 2627, slip op. at 2-4.

³ *Id.* at 6-7.

⁴ *Id.* at 7-11.

⁵ *Id.* at 8-11.

⁶ *Id.* at 6,10-11. During the parties’ negotiations for a merger, SIGA and PharmAthene also negotiated and entered into a bridge loan agreement, which contained a substantially identical provision obligating the parties to negotiate in good faith a definitive license agreement upon any termination of the merger negotiations and to which a copy of the LATS was attached as an exhibit. *Id.* at 10-11.

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Between the execution of the merger agreement and the date after which either party could terminate the merger agreement in accordance with its terms, which was September 30, 2006 (the “drop-dead date”), SIGA reached “several milestones” in the development of ST-246.⁷ When the drop-dead date approached and one of the conditions to the merger remained unsatisfied, PharmAthene asked SIGA to extend the drop-dead date.⁸ In response, SIGA sent a notice to PharmAthene terminating the merger agreement after the drop-dead date had passed.⁹

Following the termination of the merger agreement, PharmAthene sent SIGA a proposed license agreement containing, in PharmAthene’s view, terms consistent with the LATS.¹⁰ SIGA responded by sending PharmAthene a draft LLC agreement that contemplated a partnership arrangement and contained terms that were substantially different from the terms set forth in the LATS.¹¹ SIGA informed PharmAthene that SIGA did not consider the LATS binding and issued an ultimatum that the parties had “nothing more to talk about” unless PharmAthene was prepared to negotiate “without preconditions” regarding the LATS’s binding nature.¹² Subsequently, PharmAthene filed suit against SIGA in the Delaware Court of Chancery claiming, among other things, breach of contract, promissory estoppel and unjust enrichment.¹³

After a trial, Vice Chancellor Parsons determined that SIGA was liable for breach of its obligation to “negotiate in good faith a definitive license agreement in accordance with the LATS’s terms” and that “the proper remedy was an equitable payment stream approximating the terms of the license agreement to which [the Vice Chancellor] found the parties would ultimately have agreed.”¹⁴

The Court’s Analysis

On appeal to the Delaware Supreme Court, Chief Justice Steele analyzed the enforceability of a contractual obligation to negotiate in good faith in accordance with a term sheet.¹⁵ Holding that an express contractual obligation to negotiate in good faith is binding on the contracting parties, the Court turned to the question of whether the language “in accordance with the terms set forth in the LATS” in the merger agreement obligated the parties to negotiate toward a license agreement with economic terms substantially similar to the terms of the LATS.¹⁶

The Court, while noting that the LATS itself was not signed and contained a footnote on each page that stated “Non Binding Terms,” affirmed the Vice Chancellor’s finding that the incorporation of the LATS into the merger agreement reflected “an intent on the part of both parties to negotiate toward a license agreement with economic terms substantially similar to the terms of the LATS.”¹⁷ The Court also agreed with the Vice Chancellor’s finding, based on extrinsic evidence, that SIGA failed to negotiate in good faith because, among other things, SIGA “disregarded the LATS’s terms and attempted to negotiate a definitive license agreement that contained economic and other terms drastically different and significantly more favorable to SIGA than those in the LATS.”¹⁸

In addition, the Court held that where the parties have a preliminary agreement to negotiate in good faith based on certain agreed-upon major terms (while other terms remain open for further negotiation) and the trial court finds as fact that the parties would have reached final agreement but for the defendant’s bad faith negotiations, the plaintiff may be entitled to recover expectation damages to the extent such damages can be proven with reasonable certainty.¹⁹ Since this was the first time the Delaware Supreme Court has clarified this question of damages, the Court reversed the Vice Chancellor’s damages award and remanded the case for reconsideration consistent with the Court’s opinion.²⁰

7 *Id.* at 10-12.

8 *Id.* at 12.

9 *Id.*

10 *Id.* at 13.

11 *Id.* at 14.

12 *Id.* at 15.

13 *Id.*

14 *Id.* at 16-17.

15 *Id.* at 2.

16 *Id.* at 22, 26 (quoting *PharmAthene III*, 2011 WL 4390726, at *22 (Del. Ch. Sept. 22, 2011)) (internal quotation marks omitted).

17 *SIGA Tech.*, C.A. No. 2627, at 26-27 (quoting *PharmAthene III*, 2011 WL 4390726, at *22) (internal quotation marks omitted).

18 *SIGA Tech.*, C.A. No. 2627, at 28-29 (quoting *PharmAthene III*, 2011 WL 4390726, at *8, 22, 24) (internal quotation marks omitted).

19 *SIGA Tech.*, C.A. No. 2627, at 33, 36-37 n.99 (citation omitted).

20 *Id.* at 37-38.

Takeaways

- A party should be wary of agreeing, whether through a letter of intent or otherwise, to a contractual obligation to negotiate in good faith the terms of a transaction, since a failure to reach final agreement for the transaction may result in liability for breach of contract based on extrinsic evidence.
- A party should be cautious when incorporating a term sheet into an agreement that requires the parties to negotiate in good faith the transactions contemplated by the term sheet. Depending on factual findings regarding the parties' intent, a Delaware court may interpret the term sheet as setting the general boundaries within which the parties are obligated to negotiate in good faith with a view to reaching final agreement, even if the term sheet itself states that it is not binding on the parties.
- When agreeing to incorporate a term sheet into an agreement that obligates the parties to negotiate in good faith the transactions contemplated by the term sheet, a party should consider, if desired, appropriately qualifying such obligation to ensure flexibility to deviate from the terms outlined in the term sheet, such as including a provision in the agreement that expressly states that the terms set forth in the term sheet are subject to further negotiation and are not binding on the parties.
- Where parties have agreed to negotiate in good faith based on a term sheet and final agreement is not reached because a party's proposed terms are substantially dissimilar from those set forth in the term sheet, a Delaware court may award expectation damages that are proven with reasonable certainty if the court finds that an agreement would have been reached had such party not acted in bad faith.²¹

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²¹ The Court described "bad faith" to mean: "not simply bad judgment or negligence, but rather . . . 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." *Id.* at 28 (citation and internal quotation marks omitted).