

# Client Alert

Current Issues Relevant to Our Clients

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## Delaware Supreme Court Enforces an Express Agreement to Negotiate in Good Faith; Awards Expectation Damages

In *SIGA Technologies, Inc. v. PharmAthene, Inc.*, the Delaware Supreme Court (the “Court”) held that under Delaware law agreements to negotiate in good faith in accordance with the terms set forth in a term sheet are enforceable. The Court upheld a finding by the Chancery Court of the State of Delaware (the “Chancery Court”) that a party breached this good faith covenant by insisting on terms that were inconsistent with the terms set forth in the term sheet. Because the Chancery Court found that the parties would have reached a definitive agreement had they negotiated in good faith, the Court held that the non-breaching party is entitled to recover contract expectation damages and is not limited to reliance damages measured by its out-of-pocket costs and expenses.

### Background

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PharmAthene, Inc. (“PharmAthene”) and SIGA Technologies, Inc. (“SIGA”) are both Delaware corporations engaged in the biodefense research and development business. Following a series of discussions with respect to an antiviral drug being developed by SIGA, the parties entered into a bridge loan agreement and a merger agreement. Each of the agreements contained a provision whereby the parties agreed that if the merger agreement was terminated, the parties would negotiate a license agreement in good faith in accordance with the terms set forth in an attached term sheet. The term sheet was not executed by the parties and contained a footer on each page stating “Non Binding Terms.” Following the termination of the merger agreement by SIGA, PharmAthene attempted to negotiate a license agreement with SIGA in accordance with the term sheet. SIGA proposed a license agreement which included economic and other terms drastically different and more favorable to SIGA than those set forth in the term sheet. SIGA disputed that the term sheet was binding because of the “Non Binding Terms” footer. PharmAthene subsequently filed suit in the Chancery Court claiming, among other things, that SIGA breached its agreement to negotiate the license in good faith in accordance with the term sheet. The Chancery Court found that SIGA breached its covenant to negotiate in good faith and the parties cross-appealed to the Court.

### Discussion

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The Court reaffirmed that under Delaware law an express contractual obligation to negotiate in good faith is binding on the contracting parties and is enforceable. The express contractual language in the bridge loan agreement and merger agreement obligated the parties to negotiate in good faith toward a license agreement in accordance with the terms set forth in the term sheet, which was attached to both the bridge loan agreement and the merger agreement. Although the term sheet was not signed and contained a footer on each page stating “Non Binding Terms,” the Court found that the record supported the Chancery Court’s factual conclusion that incorporation of the term sheet into the bridge loan agreement and 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 set forth in the term sheet if the merger was not consummated. In upholding the Chancery Court’s finding that SIGA acted in bad faith in negotiating the license agreement, the Court noted that SIGA proposed economic and other terms that “virtually disregarded” the term sheet’s economic principles and that SIGA left the license agreement negotiations to persons who had no involvement in the prior discussions respecting the term sheet. The Court also noted that the presence of evidence that SIGA experienced seller’s remorse during merger negotiations bolstered the Chancery Court’s finding that SIGA failed to negotiate the license agreement in good faith.

When it came to the proper remedy to apply, the Court observed that its prior jurisprudence has left open the question of whether expectation damages were available in these circumstances or whether a non-breaching party was limited to reliance damages measured by its out-of-pocket costs and expenses. The Court clearly answered this question by holding that where parties have a so-called “Type II” preliminary agreement (an agreement where certain major terms are agreed-upon, but other

terms are left for further negotiation) to negotiate in good faith, and there is a finding that the parties would have reached a final agreement but for a party's bad faith negotiations, the non-breaching party is entitled to recover contract expectation damages. In the present case, the Court found that the Chancery Court's factual conclusions supported a finding that SIGA and PharmAthene entered into a Type II preliminary agreement and that SIGA breached this agreement by proposing terms inconsistent with the term sheet. Because the basis of the Chancery Court's damages award was unclear, the Court reversed the Chancery Court's damages award and remanded the case for reconsideration of the damages award consistent with the Court's opinion in this case.

This decision underscores the need for caution when executing any type of preliminary agreement, particularly including letters of intent, term sheets and statements of work. Where a party enters into a preliminary agreement that includes an express covenant to negotiate in good faith, under Delaware law a party may face exposure to contract liability expectation damages in connection with the negotiation of the definitive agreement by requesting terms inconsistent with the terms agreed upon in the preliminary agreement.

## For More Information

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