

## Client Alert

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### Delaware Supreme Court: Bad-Faith Attempt to Renegotiate Term Sheet May Create Liability for “Benefit-of-the-Bargain” Damages

By Grant L. Kim

A term sheet can play a useful role by allowing the parties to focus on key issues first, without getting bogged down in details. But what happens when a party agrees to a term sheet but insists on very different terms for the final contract?

The Delaware Supreme Court held in *Siga Technologies, Inc. v. PharmAthene, Inc.*, No. 314, 2012, \_\_\_A.3d\_\_\_, 2013 WL 2303303 (Del. May 24, 2013), that a bad-faith failure to negotiate a final deal based on a term sheet may have harsh consequences. The breaching party may be liable for “benefit-of-the-bargain” damages reflecting the profits the counterparty would have received if the final contract had been signed and performed. While this ruling is based on Delaware law and the specific facts of that case, the message to negotiators is clear: Don’t agree to a term sheet unless it is explicitly non-binding or you are prepared to continue negotiations in good faith, consistent with the term sheet.

#### BACKGROUND

Defendant Siga Technologies (SIGA) urgently needed funds to complete development of a promising antiviral drug. SIGA negotiated a two-page License Agreement Term Sheet (LATS), with plaintiff PharmAthene, which contemplated a \$6 million license fee, \$10 million in milestone payments, and a running royalty on future sales of patented products. The parties orally agreed to the term sheet, but it was not signed and included a footer stating “Non Binding Terms.”

When PharmAthene proposed to change the deal to a merger instead of a license, SIGA requested bridge financing so it could continue developing the drug. PharmAthene agreed, on the condition that SIGA agreed to license the technology if the merger fell through. The parties signed a letter of intent stating that if the merger did not proceed, “SIGA and PharmAthene will negotiate in good faith with the intention of executing a definitive License Agreement in accordance with the terms set forth in the License Agreement Term Sheet.” The parties then signed a Bridge Loan Agreement and a Merger Agreement that included the same obligation to negotiate a license in good faith.

As the deadline for the merger approached, SIGA experienced “seller’s remorse” due to a series of positive developments. SIGA received \$21 million in National Institutes of Health grants to develop the drug and achieved several significant milestones. SIGA decided to terminate the Merger Agreement instead of extending the merger deadline.

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PharmAthene then proposed a License Agreement based on the term sheet. SIGA replied that the term sheet was not binding and proposed very different terms, including (1) \$100 million instead of \$6 million in upfront license fees; (2) \$230 million instead of \$10 million in milestone payments; and (3) running royalties of 18% to 28% instead of 8% to 12% of sales. PharmAthene responded it was willing to consider some adjustments, but objected to SIGA's "radically different" terms. PharmAthene filed suit when the parties reached an impasse.

### KEY HOLDINGS

The Delaware Supreme Court held that, under Delaware law, "an express contractual obligation to negotiate in good faith is binding on the contracting parties." The court found that it had resolved any ambiguity on this issue in a recent order in a different case, which it expressly reaffirmed. The court further held that, even though the license term sheet stated it was non-binding, SIGA and PharmAthene had created an enforceable obligation by expressly agreeing in the Bridge Loan Agreement and the Merger Agreement to negotiate a license in good faith in accordance with the term sheet if the merger fell through.

The court held that the duty to negotiate in good faith required SIGA to propose terms that were "substantially similar to"—or at least not inconsistent with—the term sheet. The court ruled that SIGA had breached this obligation by insisting on different terms in "bad faith," meaning "a state of mind affirmatively operating with furtive design or ill will." The court emphasized that SIGA's chairman had "abdicated" his responsibility to remind SIGA of the terms to which it had agreed in the LATs and resorted instead to a selective and biased memory of the parties' negotiations."

The court further held that "benefit-of-the-bargain" damages could be awarded, after noting a split of authority on this issue. On the one hand, the New York Court of Appeals held in *Goodstein Constr. Corp. v. City of New York*, 604 N.E.2d 1356, 1360 (N.Y. 1992), that "New York law limits a plaintiff to reliance damages for breach of an agreement to negotiate." On the other hand, the Eighth Circuit held in *Fairbrook Leasing, Inc. v. Mesaba Aviation, Inc.*, 519 F.3d 421, 426-27 (8th Cir. 2008), that *Goodstein* did not clearly preclude expectation damages in a case where such damages could be proven. While the Eighth Circuit declined to award such damages in that case, it did so because the term sheet "was silent on significant issues," and the missing terms could not be determined by "objective criteria in the [t]erm sheet itself or in commercial practice, usage, or custom." Similarly, the Seventh Circuit held in *Venture Assoc. Corp. v. Zenith Data Sys. Corp.*, 96 F.3d 275, 278 (7th Cir. 1996), that under Illinois law, "if the plaintiff can prove that ... [but] for the defendant's bad faith the parties would have made a final contract, then the loss of the benefit of the contract is a consequence of the defendant's bad faith," and the defendant is liable for that loss if it is foreseeable.

After reviewing these cases, the Delaware Supreme Court held that "expectation" or "benefit-of-the-bargain" damages can be awarded if the plaintiff proves that the parties would have reached an agreement but for the defendant's bad faith, and the plaintiff proves the amount of such damages with "reasonable certainty." The court remanded the case for further consideration of damages under the legal standard that the court adopted.

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## IMPACT

The Delaware Supreme Court sent a clear warning that a bad-faith breach of a duty to negotiate may expose the breaching party to benefit-of-the-bargain damages. This is a significant ruling because Delaware law was previously unclear, and some other courts have allowed reliance damages only. Reliance damages are often limited to minor costs related to participating in the negotiations. In contrast, benefit-of-the-bargain damages can be huge—PharmAthene’s expert opined that expectation damages in that case were \$400 million to \$1 billion.

Actually obtaining expectation damages may be difficult because it requires proof that (1) the parties agreed to a binding obligation to negotiate; (2) there was a bad-faith breach of this duty; (3) the parties would have entered into a final contract but for this breach; and (4) the amount of expectation damages can be calculated with reasonable certainty. The last two factors are especially challenging because they may require predictions about the future. Indeed, the lower court had previously found that PharmAthene’s claimed damages were too speculative.

Nevertheless, the Delaware Supreme Court decision makes clear that a company should not agree to a term sheet unless the term sheet is explicitly non-binding, or the company is prepared to negotiate towards a final contract in good faith in accordance with the term sheet. Even when the term sheet states that it is “Non Binding”—as was true of the term sheet in *Siga Technologies*—incorporating that term sheet into a later agreement may create a binding obligation.

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## Contact:

**Grant L. Kim**  
(415) 268-7359  
[gkim@mofocom](mailto:gkim@mofocom)

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