Can A Party Be Liable For Expectation Damages Under A Non-Binding Term Sheet? Delaware Court Says Yes

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In the mergers and acquisitions context, buyers and sellers often negotiate term sheets outlining the material terms of their negotiations. Often times, the term sheet provisions are deemed binding or non-binding, or are a combination of both. Most parties would ordinarily think that non-binding provisions of a term sheet would not be enforceable in court. A recent decision handed down by the Delaware Supreme Court, *SIGA Technologies, Inc. v. PharmAthene, Inc.*, 2013 WL 2303303 (Del. May 24, 2013) (the "SIGA Case"), however, should give parties pause prior to entering into a non-binding term sheet governed by Delaware law. In the SIGA Case, the Delaware Supreme Court held that a party's agreement to negotiate the terms of a license in good faith in accordance with a term sheet was enforceable. Additionally, the breaching party could be held accountable for expectation ("benefit-of-the-bargain") damages as a result of negotiating the license in bad faith. The decision should cause parties entering into term sheets to carefully consider drafting issues including "non-binding" provisions, an agreement to negotiate in good faith, limitations on damages and governing law. This article explores the rationale of the court in rendering the decision in the SIGA Case and the implications and recommendations for parties based on the court's findings.

In the SIGA Case, SIGA Technologies ("SIGA") was developing an antiviral drug for the treatment of smallpox. SIGA was experiencing a shortfall of cash to develop the drug and, as a result, discussed strategic alternatives with PharmAthene. SIGA negotiated a term sheet with PharmAthene which contemplated a cash infusion of approximately $16 million in connection with a license agreement (the "LATS"). The unsigned term sheet included a footer that it was non-binding. PharmAthene then indicated to SIGA that it was more interested in pursuing a merger agreement than a license agreement. Ultimately, the parties discussed a merger agreement pursuant to which the parties agreed that if the parties were unable to enter into a definitive merger agreement they would negotiate in good faith to execute the license agreement in accordance with the LATS (which unsigned and non-binding term sheet was attached to the merger agreement as an exhibit).

As the end of the termination period for entering into the merger agreement approached, SIGA's financial position materially improved. SIGA received a significant infusion of grant money from the National Institutes of Health for the development of the drug and achieved several milestones. PharmAthene requested an extension of the termination date to finalize the merger agreement, but SIGA declined. Following the expiration of the period for negotiating the merger agreement, PharmAthene delivered to SIGA a license agreement containing, according to PharmAthene, economic terms consistent with the LATS attached to the merger agreement. In response, SIGA returned a draft license agreement which contained terms that were materially different from the LATS and the license agreement put forward by PharmAthene. PharmAthene indicated to SIGA that it would consider changes to the LATS, but not to the extent proposed. SIGA responded that the LATS was not binding and as such, SIGA was only prepared to negotiate on the terms it presented. At that point, PharmAthene filed suit including a claim for breach of contract.

In considering the breach of contract claim, the Delaware Supreme Court held that "an express contractual obligation to negotiate in good faith is binding on the contracting parties." The Court then addressed the question whether the language in the merger agreement obligating the parties to negotiate a license in good faith if the merger was not consummated was binding on the parties. Even though the LATS stated that it was non-binding, the Court held that the obligation to negotiate in good faith created an enforceable obligation. In so holding, the Court concluded that SIGA was required to negotiate a license with economic terms substantially similar to those set forth in the LATS. Based on SIGA's insistence on substantially different terms from the LATS, the Court held that SIGA had engaged in bad faith and breached the contract.

The Court then addressed damages. The Court held that PharmAthene was entitled to expectation or benefit-of-the-bargain damages noting that the parties would have reached agreement on the license terms but for SIGA's bad faith. The Court reached this conclusion even though there was no certainty regarding the final terms of the license. The Court then remanded the case for additional consideration of the damages issue. The Court's holding is at odds with holdings and damages awards from other jurisdictions including Massachusetts and New York. Other courts have awarded reliance damages in such situations which tend to be much smaller awards.

The decision of the Delaware Supreme Court sends a clear message to parties negotiating term sheets governed by Delaware law. A party should think carefully before entering into a term sheet that obligates such party to negotiate in good faith. The breaching party risks a court award that could result in benefit-of-the-bargain damages. The parties should make clear that the term sheet is intended to be non-binding and should either remain silent on the obligation to negotiate in good faith or should affirmatively disclaim an obligation to proceed with the terms set forth therein. In addition, the parties may want to clarify that the commercial terms set forth in the term sheet are made subject to further negotiation. Finally, the parties may want to explicitly limit the remedies available in the event of a breach to liquidated damages.

For further information on this topic, please contact **Joseph C. Marrow**.