

MARKET ALERT¹ | Be careful what you wish for: Delaware Supreme Court on the enforceability of an express obligation to negotiate in good faith

Most term sheets and/or letters of intent include non-binding provisions. However, disclaimers should be properly crafted and extra care should be used to make sure that the true intent of the parties is reflected, even in a preliminary document.

An opinion issued from the Delaware Supreme Court on May 24, 2013² reminds us that an express obligation to negotiate in good faith is binding on the parties. In addition, addressing the issue of contract expectation damages, the Delaware Supreme Court held that if it can be proven “*..that the parties would have reached an agreement but for the defendant’s bad faith...the plaintiff is entitled to recover expectation damages*”³.

PharmAtene, Inc. (“Pharmatene”) and Siga Technologies, Inc. (“Siga”), a biotech company in need of financing to develop a new drug, started talks to merge. However, they decided to enter a licensing agreement before discussing merger plans, in view of - among other reasons - Siga’s immediate need for cash. A license agreement term sheet was drafted, which included a footer, on each page, stating its non binding nature. The term sheet was never executed, as the parties eventually decided to resume the merger negotiations. In the meantime they decided that a bridge loan be provided to Siga, to provide for the funds necessary to develop the drug during merger negotiations. A merger letter of intent and a bridge loan agreement were executed, both of which referring to, and attaching, the original license term sheet. The merger letter of intent included a provision that the parties “*..will negotiate the terms of a definitive License*

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² *Siga Technologies, Inc. v. Pharmathene* (Del. May 24, 2013, C.A. No. 2627) can be found [here](#). An article from Bloomberg following the Delaware Supreme Court’s opinion can be found [here](#).

³ *Id.* at 37.

*Agreement in accordance with the terms set forth in the Term Sheet..*⁴”, while the bridge loan agreement, governed by New York law, obligated that the parties to “*..negotiate in good faith with the intention of executing a definitive License Agreement*⁵..”, in the event the merger would not fall through, or in the event of termination of the merger agreement. However, after Siga opted for an early termination of the merger agreement, the parties met to negotiate the license agreement, and Siga submitted a new, revised proposal, substantially different from the term sheet. When Pharmatene noted that the parties were bound by the term sheet, Siga responded that the term sheet was not binding “*..because of the Non Binding Terms footer*⁶.” Eventually, Pharmatene filed suit in the Delaware Court of Chancery.

After ruling on the law applicable to the matter⁷, the Delaware Supreme Court reviewed, *de novo*, the opinion issued by the Delaware Court of Chancery, that “*..an obligation to negotiate in good faith..*” was breached by Siga⁸. Despite Siga’s claim that the term sheet contained a non binding disclaimer, and that binding a party to submit a proposal that is substantially similar to a non binding term sheet would introduce a “*..dangerous uncertainty..*”⁹ in the legal system, the Delaware Supreme Court reaffirmed its opinion¹⁰, that “*..an express contractual obligation to negotiate in good faith is binding on the contracting parties*¹¹..”, even if the term sheet contained a non binding disclaimer¹². Although the license term sheet included a footing expressly stating its non binding nature, its incorporation in both, the merger agreement and the bridge loan agreement reflects the parties’ intent to be bound to negotiate in good faith an agreement with “*..terms substantially similar to the terms of the..*” term sheet¹³. It may be argued that, the

4 *Id.* at 8.

5 *Id.* at 10.

6 *Id.* at 15.

7 *Id.* at 21. In reviewing which choice of law was applicable - between Delaware law, governing the merger agreement, and New York law, governing the bridge loan agreement - the Delaware Supreme Court affirmed the Delaware Court of Chancery’s opinion, applying Delaware law, as the merger agreement was the most recent, and the its scope was broader than the scope of the bridge loan agreement.

8 *Id.* at 21.

9 *Id.* at 21 n. 41.

10 In *Titan Investment Fund II v. Freedom Mortgage Corp.* (Del. Super. March 27, 2012) the Delaware Supreme Court held that “*..a letter agreement and a term sheet created an enforceable obligation that the parties negotiate...in good faith..*”

11 *Id.* at 22.

12 In reviewing the Delaware Court of Chancery’s opinion, the Delaware Supreme Court considered Delaware Court decisions applying New York law principles. In *Vs & A Communication Partners, L.P. v. Palmer Broadcasting Limited Partnership* (Del. Ch. November 16, 1992), interpreting New York law, the Delaware Court of Chancery concluded that “*..obligations to negotiate are said to be invalid or unenforceable where material aspects of the contract remain open..*”

13 *Id.* at 27.

incorporation of the term sheet, by reference in the two agreements, defeated its non binding nature.

In assessing the issue of whether the plaintiff is entitled to recover expectation damages, the Delaware Supreme Court refers to the concept of Type I vs. Type II preliminary agreements¹⁴. Where a Type I agreement is “..a *fully binding preliminary agreement, which is created when the parties agree on all the points that require negotiation (including whether to be bound) but agree to memorialize their agreement in a more formal document*¹⁵.”, a Type II Agreement occurs when the parties “..agree on certain major terms, but leave other terms open for further negotiation¹⁶.” Since the parties created a Type II preliminary agreement, the Delaware Supreme Court held that Pharmatene is entitled to recover expectation damages¹⁷.

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¹⁴ *Id.* at 33, referring to Federal Courts interpreting New York in *Fairbrook Leasing, Inc. v. Mesaba Aviation, Inc.*, F.3d 421, 426-27 (8th Cir. 2008) and *Adjustrite Sys., Inc. v. GAB Bus. Serv., Inc.*, 145 F. 543, 548 (2nd Cir. 1998).

¹⁵ *Id.* at 33, referring to *Fairbrook* F.3d 421, 426-27.

¹⁶ *Id.* at 33, referring to *Adjustrite*, 145 F.3d at 548.

¹⁷ *Id.* at 37.