

KIRKLAND M&A UPDATE

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Good Faith — Not Just an Aspiration

A recent case serves notice that, even when the terms themselves fall short of creating a binding agreement, an agreement to negotiate definitive documentation in good faith could very well mean just that.

In a recent [Kirkland M&A Update](#), we reviewed a Georgia appellate decision upholding a \$281 million jury award to a spurned suitor, showing that even careful drafting of “non binding” language in a letter of intent may not be effective in avoiding unanticipated binding obligations if the parties’ conduct is inconsistent with those provisions. We also noted, in an earlier [Kirkland M&A Update](#), a Delaware decision underlining the potential pitfalls for parties entering into letters of intent or term sheets with the expectation that they merely represent an unenforceable “agreement to agree.” A recent Delaware [decision](#) by VC Parsons highlights that danger lurks for unwary dealmakers even when a court comes well short of finding a term sheet to be a binding agreement.

SIGA Technologies was developing a smallpox drug with big potential but lacked the financial resources and operational expertise to bring it to market. In late 2005, SIGA and PharmaThene began exploring a possible collaboration regarding development and commercialization of the drug. After extensively discussing a “non-binding” license agreement term sheet, PharmaThene gave SIGA a bridge loan and ultimately entered into a merger agreement with SIGA in 2006. Both the bridge loan and merger agreement attached the term sheet and provided that, in the event of a failure of the merger, the parties would “negotiate in good faith with the intention of executing” a license agreement reflecting the content of the term sheet. During the pendency of the merger, PharmaThene provided continued support to SIGA and the drug achieved certain milestones, improving the prospects of SIGA as a standalone enterprise. When the merger failed to close during the prescribed timeframe, subsequent negotiations over the definitive license agreement quickly fell apart with SIGA proposing terms that were much less favorable to PharmaThene than those in the term sheet.

In a decision rife with criticism of SIGA’s actions and attitude with respect to its relationship with PharmaThene, VC Parsons denied PharmaThene’s claim that the term sheet attached to the merger and bridge loan agreements was a binding agreement, pointing in part to a “Non-Binding” footer printed on the page and the absence of agreement on all material terms. Nonetheless, the court held that PharmaThene was entitled to damages for breach of SIGA’s contractual obligation to negotiate in good faith and promissory estoppel because of SIGA’s blatant attempt to use the documentation process as a cover to extract for itself better terms. VC Parsons then took on the complex question of fashioning a remedy. He eschewed both a specific performance order because of the practical obstacles to enforcement and a lump sum penalty based on expectation damages because of its inherently speculative nature. He ultimately awarded PharmaThene the equitable right to receive a royalty stream equal to 50% of the net profits in excess of \$40 million generated by SIGA from sales of the smallpox drug for the next ten years. This payment stream reflected the court’s view of PharmaThene’s reasonable expectations had SIGA complied with its obligation to negotiate in good faith to implement the term sheet. Upon announcement of the court’s decision, SIGA’s stock price promptly dropped over 40%.

In this fact-specific decision the court was likely swayed by PharmaThene having gone out on a limb to help SIGA through a time of uncertainty with both financial and operational help, only to have SIGA turn around in flush times and deny PharmaThene the benefits it reasonably expected (and bargained for) in exchange for its efforts. VC Parsons seems particularly bothered by the fact that during the aborted negotiations of the definitive license agreement SIGA served up a draft LLC agreement that, in the court’s words, “bore no resemblance to the economic terms” of the term sheet.

During preliminary negotiations, parties very often undertake the seemingly gratuitous and innocuous obligation to act or negotiate in good faith to seek to implement the terms of a manifestly, and often explicitly, non-binding term sheet or letter of intent. This case serves notice that, even when the terms themselves fall short of creating a binding agreement, an agreement to negotiate definitive documentation in good faith could very well mean just that.

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