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# When a Non-Binding Term Sheet Becomes Binding

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Tire-kickers, prevaricators and those who might otherwise agree on a term sheet with little intention of closing the deal beware: A “non-binding” term sheet is sometimes binding. At least so says the Delaware Supreme Court. In*SIGA Technologies v. PharmAthene, Inc.*, No. 314, 2012 2013 Del. LEXIS 265, 1-2 (Del. May 24, 2013), Delaware’s highest court held that where a party to a detailed term sheet breaches its duty to negotiate in good faith, the spurned party may be entitled to recover an award of so-called “benefit of the bargain” contract damages. In such a case, the breaching party would be required to pay the non-breaching party an amount equal to the value the non-breaching party could have reasonably expected to receive under a definitive agreement having the same terms as set forth in the term sheet. This alert discusses the *SIGA* case and proposes ways to mitigate the risk that a court might award expectation damages based on a “non-binding” term sheet or letter of intent.

## *SIGA Technologies v. PharmAthene, Inc.*

In *SIGA*, PharmAthene — a pharmaceutical company specializing in “biodefense” against chemical weapons such as anthrax — sued to enforce a term sheet for a license agreement with SIGA. The relationship began like many drug development collaborations: SIGA had acquired an untested, unproven treatment for smallpox, but it had limited resources. As a result, it sought funding, ultimately entering into discussions with PharmAthene to help it finance development of the product. PharmAthene proposed a merger of the two companies but SIGA, although cash strapped, was hesitant. The parties nonetheless negotiated and agreed on a definitive merger agreement and a similarly detailed term sheet for a license agreement just in case the merger fell through. During the negotiations, SIGA asked PharmAthene for a bridge loan to cover SIGA’s ongoing development costs. PharmAthene agreed to the loan on the condition it would, at minimum, receive a license for the product. Both the bridge loan documents and the merger agreement included language confirming that if the merger fell through, the parties would

> negotiate in good faith with the intention of executing a definitive License in accordance with the terms set forth in the License Agreement Term Sheet attached. . . . (*SIGA,* 2013 Del. LEXIS 265 at 13.)

Before the parties concluded a merger, SIGA secured over $21 million in grant money from the National Institutes of Health to complete the product's development. SIGA then terminated the merger agreement when the “drop dead” date came before the merger could be consummated.

After the announcement, PharmAthene sent SIGA a proposed license agreement consistent with the license agreement term sheet. SIGA rejected the license agreement and tried to renegotiate significantly more favorable terms. Negotiations broke down, and PharmAthene sued.

The *SIGA* court held that expectation or “benefit of the bargain” damages would be an appropriate remedy where (1) the parties memorialized the basic terms of a transaction in a term sheet; (2) the parties expressly agreed to negotiate in good faith a final transaction in accordance with those terms; and (3) but for the breaching party’s bad faith negotiations, the parties would have consummated a definitive agreement having the terms set forth in the term sheet. *See SIGA,* 2013 Del. LEXIS 265 at 52. Benefit of the bargain damages are meant to compensate a party with what it would have received had the contract been finalized and fully performed. It is usually measured in terms of reasonably expected profits. The reliance measure of damages, in comparison, provides reimbursement to the non-breaching party for expenses it incurred in reliance on the contract.

The *SIGA* court’s decision is notable for the remedies it contemplates, *i.e.*, expectation damages, not for its determination that a party can be held liable for breaching a duty to negotiate in good faith. Numerous courts have recognized a cause of action for breach of a duty to negotiate in good faith.[1] In fact, at least one California court has gone so far as to recognize a cause of action for breach of the implied covenant of good faith and fair dealing in a case where the parties’ term sheet did not expressly impose an obligation to negotiate in good faith. *Copeland v. Baskin Robbins U.S.A.*, 96 Cal. App. 4th 1251 (2002). But these prior court rulings have typically favored reliance, not expectancy damages.[2]

## Recommendations and Proposed Language

Although the *SIGA* case turned on facts specific to the negotiating history between SIGA and PharmAthene, the decision will likely be cited in future cases brought by spurned parties to unsuccessful negotiations. To mitigate the risk of the unintended enforcement of a letter of intent or term sheet, parties should consider including language expressly disclaiming a duty to negotiate in good faith and stating the parties’ intent that neither subsequent communications nor course of conduct will give rise to binding obligations before a definitive agreement is signed. For example, parties negotiating a letter of intent might wish to use language similar to the following:

> The parties agree that this letter of intent does not constitute a binding commitment by either party with respect to any transaction, [with the exception of the confidentiality and exclusivity sections set forth above.] The non-binding provisions of this letter of intent reflect only the parties’ current understanding of the contemplated transaction, and a binding contract will not exist between the parties unless and until they sign and deliver one or more definitive agreements, which will contain material terms not set forth in this letter of intent. No obligations of one party to the other (including any obligation to continue negotiations) or liability of any kind shall arise from executing this letter of intent, a party’s partial performance of the terms of this letter of intent, its facilitating or conducting due diligence, its taking or refraining from taking any actions relating to the proposed transaction or any other course of conduct by the parties [other than breach of the confidentiality and exclusivity provisions set forth above]. The parties agree that neither party shall have a duty to negotiate in good faith and that either party may discontinue negotiations at any time for any reason or no reason.

Any letters, drafts or other communications shall have no legal effect and shall not be used as evidence of any oral or implied agreement between the parties.

Of course, language alone may not provide an effective safeguard against breach of contract lawsuits based on “non-binding” term sheets. Parties also should be cautious in their communications and actions to avoid inadvertently obligating themselves to the terms of a letter of intent or a duty to negotiate in good faith. For example, a party should refrain from accusing the other party of “breaching” the non-binding provisions of the letter of intent and avoid internal or external communications to the effect that the deal is done before definitive agreements are signed. A party also should proceed with caution in demanding economic terms more favorable than those expressly set forth in the term sheet. Courts often cite such “re-trading” as evidence of bad faith.[3]

## Conclusion

Although letters of intent and term sheets represent the first step in nearly all negotiated corporate transactions, parties should be aware of court rulings enforcing purportedly non-binding letters of intent. Parties should proceed with caution when drafting letters of intent or term sheets and in their course of conduct surrounding the negotiations of definitive agreements to help ensure they are not later bound to their non-binding letter of intent or term sheet.

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[1] *Goodstein Constr. Corp. v. City of New York*, 604 N.E.2d 1356 (N.Y. 1992); *Venture Associates Corp. v. Zenith Data Systems Corp.*, 96 F.3d 275 (7th Cir. 1996) (applying Illinois law); *Brady v. State*, 965 P.2d 1, 11 (Alaska 1998) (“Many courts enforce promises to negotiate in good faith . . . . Most courts that do so limit relief to reliance damages.”).

Promises to negotiate are not, however, universally enforced. *See Chambers v. Gold Medal Bakery, Inc.*, 83 Mass. App. Ct. 234, 247-248 (Mass. App. Ct. 2013) (“[A] mere commitment to negotiate in good faith is of limited enforceability. Even if such an agreement were deemed to have some incremental force beyond a mere agreement to agree, it ultimately would be unenforceable if either party credibly could claim that a good faith dispute remained.”); *485 Lafayette St. Acquisition, LLC v. Glover Estates, LLC*, 2012 Mass. Super. LEXIS 207, 20 (Mass. Super. Ct. May 14, 2012), citing *Schwanbeck v. Federal-Mogul Corp.*, 412 Mass. 703, 706, 592 N.E.2d 1289 (1992) (language in a letter of intent calling for the parties to “proceed to negotiate in good faith a definitive Joint Venture Agreement is merely a promise made with an understanding that it is not to be legally binding, but only a statement of present intention . . . . ‘An expression of present intent is not a contract.’”).

[2] For example, the New York Court of Appeals held that New York law limits a plaintiff to reliance damages for breach of a duty to negotiate. *See Goodstein Constr. Corp.,* 604 N.E.2d at 1360. *See also Copeland.* 96 Cal. App. 4th at 1263-64 *(*applying California law*); L-7 Designs, Inc. v. Old Navy, LLC*, 647 F.3d 419, 431 (2d Cir. N.Y. 2011) (citing*Goodstein)* (lost profits not available where no agreement is reached).

Although the *SIGA* decision appears to represent the first case in which a state’s highest court has ruled in favor of expectancy damages for breach of a duty to negotiate in good faith, federal courts and lower state courts, including the Delaware Court of Chancery, have found expectancy damages to be appropriate in certain circumstances. For example, in 1996, Judge Richard Posner, writing for the Seventh Circuit and applying Illinois law, stated in dicta that “[d]amages for breach of an agreement to negotiate may be . . . the same as the damages for breach of the final contract that the parties would have signed had it not been for the defendant’s bad faith.” *Venture Associates, 96 F.3d* at 278-79. *See also RGC Int’l Investors, LDC v. Greka Energy Corp.*, 2001 Del. Ch. LEXIS 107, 53 (Del. Ch. Aug. 22, 2001) overruled on other grounds by *Scion Breckenridge Managing Member, LLC v. ASB Allegiance Real Estate Fund*, 2013 Del. LEXIS 235, 48 (Del. May 9, 2013); *Milex Products, Inc. v. Alra Laboratories, Inc*., 237 Ill. App. 3d 177 (Ill. App. Ct. 1992).

[3] *See, e.g.*, *SIGA*, 2013 Del. LEXIS 265, 40.