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Case Study: PharmAthene V. SIGA

Law360, New York (October 13, 2011, 1:22 PM ET) -- On Sept. 22, 2011, the Delaware Chancery Court awarded PharmAthene Inc. a 50-percent share of profits above a certain threshold amount from sales of SIGA Technology Inc.'s pharmaceutical product known as ST-246, due to SIGA's failure to negotiate in good faith for the grant of a license to PharmAthene.

The outcome of this case provides an important reminder to executives, attorneys and business development professionals that an obligation to negotiate in good faith is an enforceable obligation, which, if breached, can result in a significant award of damages.

Background of the Case

In 2004, SIGA acquired from ViroPharma Inc. the rights to ST-246, an orally administered antiviral drug for the treatment of smallpox. In late 2005, with SIGA facing financial difficulties, it began discussing a possible merger or collaboration with PharmAthene with respect to ST-246.

In June 2006, several months after PharmAthene loaned $3 million to SIGA under a bridge loan agreement, the parties signed a merger agreement. The merger agreement provided that if the merger was terminated, the parties would negotiate a definitive license agreement in accordance with a two-page term sheet attached as an exhibit to the merger agreement.

The term sheet itself was unsigned and included a footer indicating it was nonbinding. It provided for a worldwide, exclusive license to PharmAthene, described the creation and responsibilities of a joint research and development committee, funding of research and development by PharmAthene according to a defined budget, a $6 million license fee payable in tranches if certain events occurred, milestone payments totaling $10 million, tiered royalties of 8 percent to 12 percent, and 50 percent of any amounts by which net margin exceeds 20 percent on sales to the U.S. federal government. The merger agreement also included a provision obligating the parties to use best efforts to carry out and consummate the transactions contemplated by the merger agreement.

During the pendency of the merger, the National Institutes of Health awarded SIGA $16.5 million for the development of ST-246. In October 2006, SIGA elected to terminate the merger. The parties then began to negotiate the terms of a license agreement as required by the merger agreement. However, instead of following the terms from the previously agreed-upon term sheet, SIGA initially proposed a different structure: a 50-50 profit share and an upfront license fee of $40 million to SIGA.

However, after PharmAthene indicated a willingness to consider such an alternative structure, SIGA proposed another set of terms: a $100 million upfront payment, milestone payments totaling $235 million, tiered royalties from 18 percent to 28 percent, and 50 percent of any remaining profits. In December 2006, PharmAthene brought suit against SIGA.

Court's Decision and Analysis

While the court found that the parties did not enter into a definitive license agreement by attaching the licensing term sheet to the merger agreement, the court found that SIGA breached its contractual obligation to negotiate a license agreement in good faith with PharmAthene. Once the merger agreement was terminated, SIGA proposed terms that were significantly more favorable to SIGA than those in the term sheet attached to the merger agreement.

The court indicated that under Delaware law, bad faith constitutes "not simply bad judgment or negligence, but rather … the conscious doing of a wrong because of dishonest purpose or moral obliquity; it is different from the negative idea of negligence in that it contemplates a state of mind affirmatively operating with furtive design or ill will."

Therefore, the defendant's conduct must be "motivated by culpable mental state or driven by an improper purpose that rises to a high level of egregiousness." The court had previously held in the context of a duty to negotiate in good faith that "an attempt to condition future agreement on a previously contested and compromised point is an unambiguous act of bad faith where the other party performed in reliance on that compromise."

The court found that PharmAthene made the requisite showing in this case because the parties had contested and compromised the primary economic terms for a license, PharmAthene acted in reliance on that compromise, and SIGA disregarded those terms and attempted to negotiate an agreement containing terms "drastically different and significantly more favorable to SIGA than those in the term sheet."

According to the court, the parties were required "to negotiate in good faith a license agreement with economic terms substantially similar to those contained in the [term sheet]," and SIGA breached that obligation. The court further found that PharmAthene was entitled to relief under the doctrine of promissory estoppel.

With respect to damages, the court found that absent SIGA's bad faith negotiations, the parties likely would have entered into a license agreement generally in accordance with the terms in the term sheet. Based on the discussions between the parties after the merger was terminated, including PharmAthene's willingness to consider other deal structures, the court found that PharmAthene likely would have accepted a 50-50 profit split with an upfront payment of approximately $40 million.

Using principles of constructive trust and equitable lien, the court ordered SIGA to pay PharmAthene 50 percent of profits in excess of $40 million from sales of ST-246 and related products for a period of 10 years after first commercial sale of any product derived from ST-246.

Conclusion and Practice Points

The PharmAthene v. SIGA case serves as a pointed reminder that obligations to negotiate in good faith are enforceable and should not be taken lightly. While the specific facts and circumstances of each case will be of critical importance, parties should recognize that a showing of bad faith and potentially substantial damages may follow from a party's attempted negotiation of materially different and more favorable terms compared to terms previously agreed upon by the parties. The more terms that are agreed upon in advance by the parties, the stronger will be an obligation to negotiate an agreement consistent with those terms. Of course, each factual situation may differ and requires careful consideration.

Practitioners and companies should exercise caution in agreeing to obligations to negotiate in good faith where there may not be a serious commitment to reach agreement or where an intervening change in circumstances may materially alter the relative benefit or burden of predetermined terms.

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