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Comparing Strategies in *MFW Shareholders* and *Siga v. PharmAthene*

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Today it is not a matter of whether a large corporate transaction will result in a lawsuit, but a matter of when and where. The Delaware Court of Chancery presides over an evolving and sophisticated body of law in which the apparent fairness of outcomes and reasonableness of negotiation and litigation decisions are intertwined and matter a great deal. Parties anticipating review, or even hoping to avoid it, would be wise to heed the lessons learned from 2013 and integrate litigation strategies at the outset of corporate decision-making.

Of the two cases selected for discussion here, *In re MFW Shareholders Litigation*, 67 A.3d 496 (Del. Ch. 2013), reflects a thoughtful pre-litigation strategy in which the transaction was structured with an eye toward favorably developing the case law. Counsel were rewarded with a ruling that provides defendants with an opportunity to have going-private transactions in which a controlling shareholder conditions the transaction on approval by both an independent committee of the board of directors and a majority vote of the minority shareholders analyzed under the business judgment rule rather than the entire fairness standard.

By contrast, all indications are that the defendants in *Siga Technologies v. PharmAthene*, 67 A.3d 330 (Del. 2013), took a different strategic approach and made aggressive tactical decisions that may have appeared more harshly to a court of equity than expected. In return, they face costly damages.

(Un)controlled Aggression?

Between late 2005 and early 2006, Siga Technologies Inc. negotiated a license agreement term sheet, or LATS, with PharmAthene Inc. in an attempt to resuscitate the company and finance the development of a smallpox antiviral treatment. Although the parties orally agreed to the LATS, it was never signed and the footer on both pages stated that it was "nonbinding." PharmAthene decided to pursue a merger with Siga rather than a license agreement, and Siga agreed to negotiate as long as PharmAthene provided a bridge loan. To hedge its interest in Siga's smallpox antiviral treatment, PharmAthene negotiated for a clause in the merger agreement (and also the bridge loan) stating that if the merger fell through, the parties would negotiate a definitive license agreement in good faith in accordance with the terms of the LATS, according to the draft merger sheet.

After the merger agreement was signed but prior to the closing date, three material changes in Siga's financial condition led it to experience "seller's remorse." First, Siga received a $5.4 million grant from the National Institutes of Health. Second, Siga's audit committee approved an agreement for the first human trial of its smallpox antiviral treatment. Third, the NIH awarded Siga another grant, this time for $16.5 million for the development of the smallpox antiviral treatment. Siga's stock began trading at three times its 2005 share price, and Siga's board of directors voted to terminate the merger agreement with PharmAthene, according to the opinion.

PharmAthene then sought a license agreement with Siga based on the terms of the LATS pursuant to the clause in the merger agreement and bridge loan. Siga, however, argued that the LATS was not binding and countered with terms that were starkly different from the parties' previous positions: (1) $100 million instead of $6 million in upfront license fees; (2) $230 million instead of $10 million in milestone payments; and (3) running royalties of 18 to 28 percent of sales instead of 8 to 12 percent. Siga's proposal also included several non-mone-

tary terms that were heavily favorable to its own interests.

The Delaware Supreme Court found that, under Delaware law, "an express contractual obligation to negotiate in good faith is binding on the contracting parties." In this case, even though the LATS was not signed and stated that the terms were "nonbinding," the Supreme Court agreed with the Chancery Court that "'incorporation of the LATS into the bridge loan and merger agreements reflects an intent on the part of both parties to negotiate toward a license agreement with economic terms substantially similar to the terms of the LATS if the merger was not consummated.'" The terms proposed by Siga for the license agreement after the merger fell through "'differed dramatically from the LATS in favor of Siga' to the extent that they 'virtually disregarded the economic terms of the LATS.'" The Delaware Supreme Court held that in light of the Chancery Court's finding that but for Siga's bad faith the parties would have reached a deal on the terms of the licensing agreement, PharmAthene was entitled to expectation damages.

Siga Technologies is an example in which failure to consider how a party's negotiation strategy would read to a judge came with a substantial cost. As the Delaware Supreme Court noted, Siga switched negotiating teams between the LATS and the ultimate license negotiations. This new team apparently failed to consider how their change in position and the context in which they were negotiating might result in a drastically different outcome.

The Delaware Supreme Court sent a clear warning that a breach of a duty to negotiate in good faith is both actionable and may expose the breaching party to substantial damages. As other practitioners have commented, this is a significant ruling because Delaware law was previously unclear and other courts have only awarded reliance damages. Reliance damages are often minor and drawn from the costs related to participating in the attempted transaction; by comparison, expectations damages can be huge—PharmAthene's expert opined that expectation damages were between $400 million and $1 billion.

Although actually obtaining expectation damages may be difficult, the Delaware Supreme Court made clear that express agreements to negotiate in good faith are binding and failure to do so can be costly.

Benefits of Thoughtful Strategy

In June 2011, the holding company MacAndrews & Forbes, which is itself entirely owned by Ron Perelman, owned a 43 percent controlling interest in M&F Worldwide, according to *MFW Shareholders*. MacAndrews made a public offer to purchase the remaining shares of MFW in a going-private merger; the was bid contingent on the approval of both an independent special board committee of MFW as well as the majority of MFW's minority shareholders.

MFW's board formed a special committee that engaged its own legal and financial advisers to analyze the offer. MacAndrews' negotiators and the committee met eight times over a period of three months to negotiate the proposal and the committee successfully convinced MacAndrews to raise its offer price from $24 a share to $25 a share. The merger was then approved by 65 percent of the minority MFW shareholders.

The non-approving stockholders sued and the Chancery Court considered the standard of review to apply to the transaction. Prior case law established that approval by either a special committee or the majority of the noncontrolling stockholders would shift the burden of proof under the entire fairness standard from the defendant to the plaintiff. Existing precedent did not address, however, what standard of review would apply or the appropriate burden-shifting that would be used in the event a corporation employed both, not just one, of these procedural safeguards.

MFW argued in favor of applying the business judgment rule on the grounds that defendants would only employ both procedural protections if they could be guaranteed a more lenient standard of review. The plaintiffs conceded that the use of both procedural protections was more beneficial to them than the use of only a single procedural safeguard, although still arguing in favor of the entire fairness standard.

In an opinion that closely considered the costs and benefits of the procedural safeguards from the perspective of both the plaintiffs and defendants, Chancellor Leo E. Strine Jr., writing for the Chancery Court, held that use of both an independent special committee and a majority vote of minority shareholders provided justification for the use of the business judgment rule.

The value of employing a thoughtful litigation strategy early on in deal negotiations is nothing new. These cases serve as an excellent reminder of the principle.

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