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The Duty to Negotiate in Good Faith: Are BATNA Strategies Legal?

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The Duty to Negotiate in Good Faith: Are BATNA Strategies Legal?

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INTRODUCTION

Two fundamental strategies are available to negotiators. A distributive strategy focuses on claiming as much value as possible. An integrative strategy emphasizes the identification of interests that underlie each side's position and integration of those interests in a manner that has the potential to create value for both sides.

Regardless of the strategy selected, power plays an important role. With distributive negotiations, power is a necessary component of value claiming by the parties. In an integrative negotiation, after parties have created value, they will use their relative power to determine how to divide the value.

For example, the authors of the best-selling book on negotiation, *Getting to Yes*,[1] on the one hand advocate an interest-based method reflected by these chapter titles (emphasis in original):[2] "Separate the PEOPLE from the Problem," "Focus on INTERESTS, Not Positions," and "Invent OPTIONS for Mutual Gain." But on the other hand, they emphasize the importance of power. Specifically, they note that negotiators should understand and develop their Best Alternative to a Negotiated Agreement ("BATNA"), which provides leverage and power. In their words (emphasis in original): "**The better your BATNA, the greater your power** . . . . In fact, the relative negotiating power of two parties depends primarily upon how attractive to each is the option of not reaching agreement."[3] In other words, a strong BATNA empowers a party to walk away from the negotiations.

Given the importance and centrality of the BATNA concept during negotiations, it is surprising that this fundamental question has received little attention in the negotiation literature: Is it illegal for negotiators to use BATNA strategies that improve their own alternatives and weaken the other side's alternatives?[4] Because negotiators frequently cross boundaries between different legal systems in a global economy, this article examines this question from a global perspective.

The structure of this article reflects a fundamental division in the legal world into civil law and common law systems. Most countries have a civil law system, which places heavy reliance on statutes and codes. In common law countries—including the United States, England, and India—courts rely heavily on

1. ROGER FISHER, BRUCE PATTON & WILLIAM URY, GETTING TO YES: NEGOTIATING AGREEMENT WITHOUT GIVING IN (3rd. ed. 2011).
2. *Id.* at xv.
3. *Id.* at 102.
4. GEORGE SIEDEL, NEGOTIATING FOR SUCCESS: ESSENTIAL STRATEGIES AND SKILLS (2014).

precedents,[5] although legislation is also an important source of law. Apart from the variances in sources of law, there are substantive differences between the two systems. This article focuses on one of these substantive law differences—the duty to negotiate in good faith.

Over the past several decades, theories and methods of negotiation developed in one common law country, the United States, have been transplanted far beyond their country of origin. Universities and other providers of business and legal education around the world use negotiation books, case problems, and materials originally published in the United States. Part I will first examine whether the export of these concepts to civil law countries is valid in light of fundamental differences between legal systems. Part I will then focus on the civil law duty to negotiate in good faith. In the absence of an agreement to the contrary, the default rule under the common law is that negotiation is not subject to a general duty of good faith, while the civil law default doctrine of *culpa in contrahendo* imposes this obligation. This civil law doctrine calls into question a BATNA strategy that might be considered bad faith if it leads negotiators to cease negotiating when the expected outcome does not exceed their BATNA.

Part II of this article turns to the common law, with emphasis on the United States. Despite the general U.S. rule that there is no duty to negotiate in good faith unless there is a prior agreement to do so, the exception is more complicated than appears on its face. And the consequences of failure to understand the exception can be severe. Part II uses a case study to analyze the complexity and pitfalls associated with the exception. Part II also suggests practical approaches that negotiators should consider when developing their BATNA strategies.

The article concludes with an examination of the positive impact that a duty to negotiate in good faith can have on negotiation strategy and results. Specifically, the case study analyzed in Part II provides a morality tale that illustrates the disastrous consequences when negotiators unknowingly shoulder the duty of good faith and select a value-claiming power strategy.

I. NEGOTIATION STRATEGY IN CIVIL LAW COUNTRIES

Part I examines the legal implications that arise when negotiation models are exported from the United States, a common-law country, to civil-law countries, with emphasis on the civil law duty to negotiate in good faith and its impact on negotiation strategy.

A. The Transplantation of U.S. Negotiation Theories and Method

The worldwide reach of U.S. negotiation theories and methods extends back to the pioneering texts in this field. Although the late Roger Fisher expressed

5. S.B., *What is the Difference Between Common and Civil Law?*, THE ECONOMIST, (July 16, 2013, 11:50 PM), http://www.economist.com/blogs/economist-explains/2013/07/economist-explains-10.

disappointment that *Getting to Yes* has yet to change the world,[6] it became a point of pride among Fisher and his co-authors that their 1981 bestseller had been "translated into more than 30 languages as of the 25th anniversary of its publication in 2006."[7] Co-author William Ury emphasized the international reach of *Getting to Yes* by noting that "everybody in the world becomes an audience" for the book.[8]

Law schools and business schools around the world have readily adopted *Getting to Yes* and other U.S. materials. A number of negotiation books published outside the United States in languages other than English claim to be either translations or adaptations of originals from the United States. Although no editor or translator is identified in the work itself, *Negociación y Resolución de Conflictos*[9] is stated to be an authorized Spanish translation of *Harvard Business Review on Negotiation and Conflict Resolution*.[10] Similarly, *Claves de Negociación . . . con el Corazón y la Mente*[11] by Steven Cohen and Ricardo Altimira is an adaptation and translation into Spanish of the first edition of Cohen's *Negotiating Skills for Managers*.[12]

A brief review of syllabi from non-US institutions and universities provides examples of the extent to which they use methods and materials of U.S. origin:

- In Japan, Kyoto University offered a course entitled "Management Communication (Business Negotiation)," in which the required book was *Negotiation,* 4th Edition, by Lewicki, Saunders, Minton & Barry.[13]
- In Denmark, Aarhus University offered a course entitled "Negotiation," in which the required reading consisted of *Getting to Yes,* together with *Negotiation* by Lewicki, Barry and Saunders.[14]
- In France, INSEAD business school offered a course entitled "Negotiations: Negotiation Dynamics," taught by Professor

6. Carrie Menkel-Meadow, *Why Hasn't the World Gotten to Yes? An Appreciation and Some Reflections*, 22 NEGOT. J. 475, 485 (2006).

7. Michael Wheeler & Nancy J. Waters, *The Origins of a Classic:* Getting to Yes *Turns Twenty-Five*, 22 NEGOT. J. 475, 475 (2006).

8. *Id.* at 479.

9. DANNY ERTEL, NEGOCIACIÓN Y RESOLUCIÓN DE CONFLICTOS (2001) (Arg.).

10. HARVARD BUSINESS REVIEW ON NEGOTIATION AND CONFLICT RESOLUTION (Harv. Bus. Sch. Press 2000).

11. STEVEN MARTIN COHEN & RICARDO ALTIMIRA, CLAVES DE NEGOCIACIÓN CON EL CORAZÓN Y LA MENTE (2003) (Spain).

12. STEVEN COHEN, NEGOTIATING SKILLS FOR MANAGERS, (1st ed., 2002).

13. *See* Kyoto University, Graduate School of Economics, Syllabus for Management Communication (Business Negotiation), 2009, *available at* https://ocw.kyoto-u.ac.jp/graduate-school-of-economics/management-communication-business-negotiation (retrieved Apr. 15, 2013); *and* ROY LEWICKI ET AL., NEGOTIATION (4th ed., 2002).

14. *See* Aarhus University, Syllabus for Negotiation, Summer University 2012, *available at* www.au.dk/fileadmin/www.au.dk/Negotiation_01.pdf (retrieved Apr. 15 2013); ROY LEWICKI ET AL., NEGOTIATION (7th ed., 2014).

Horacio Falcão, in which the syllabus makes reference to an extensive selection of readings including the Fisher and Lewicki texts, along with articles taken from journals and other periodicals published in the United States.[15]

- Three universities in Spain also offered courses using U.S. negotiation materials. Deusto University offered a Team Management course, including the Fisher and Ertel texts.[16] Universidad Pontificia Comillas offered an executive education course in Negotiation, featuring the methodologies of *Getting to Yes* and other U.S. texts.[17] Finally, Barcelona's Pompeu Fabra University offered a Negotiation course, with a reading list comprised of books by several U.S. authors.[18]

Although these courses may supplement the U.S.-based materials with other content specifically adapted to the respective local environments, the syllabi illustrate the extent to which U.S. negotiation materials are in use, far beyond their country of origin.

B. Problems with Exporting U.S. Negotiation Models

Although a number of authors have criticized U.S. negotiation methods and materials as culturally biased, they have failed to critique the legal implications. Instead, critics generally focus on other aspects of negotiation culture. As observed by Gelfand and Brett, "Negotiation and conflict research . . . has been criticized as being primarily developed in the United States, involving mostly Western research participants . . . . Put differently, if scholars continue to look at negotiation only through 'Western glasses,' they will inevitably miss important elements of negotiation."[19]

With regard to *Getting to Yes* and its progeny, Menkel-Meadow has pointed out their "abiding American optimism, attached to classic American

15. *See* INSEAD, Syllabus for Negotiations: Negotiation Dynamics, Jan.–Feb. 2008 (copy in possession of author).

16. *See* Universidad de Deusto, Subject Syllabus for Advanced Team Management, 1st Semester, Academic Year 2009–10, *available at* http://repstud.deusto.es/reports/rwservlet?gur01007a&par_cgacocea=230&par_cgacosea=0&par_asignatura_codigo=25319&par_gua_curso=200910&par_guo_codigo=1&par_destino=WEBPUBLICAMASPARTI&par_idioma_web=EN (retrieved Apr. 15, 2013).

17. *See* Universidad Pontificia Comillas, Syllabus for Negotiation Executive Education Program, *available at www.sp.upco.es/sites/. . ./Negociacion2809.pdf* (retrieved Apr. 15, 2013).

18. *See* Universitat Pompeu Fabra, Llicenciatura en Administración de Empresas (ADE) / Llicenciatura en Economia, Syllabus for Negotiation, Fall 2001, *available at* www.eco.uc3m.es/acabrales/teaching/2002/sylneg01.pdf (retrieved Apr. 15, 2013).

19. MICHELE J. GELFAND & JEANNE M. BRETT, THE HANDBOOK OF NEGOTIATION AND CULTURE 417 (2004).

pragmatism"[20]—two cultural values that could be perceived differently outside the cultural context of the United States.

Well-intentioned attempts to train non-U.S. individuals in negotiation skills inspired by the U.S. methodologies have encountered obstacles, as the direct applicability of these U.S. models outside their home culture has been called into question. Writing about an attempt to extend U.S.-style negotiation and mediation training to several countries in Central and South America, one U.S. scholar concluded that assuming American methods can be exported essentially unchanged also implies that these methods constitute the only right way to think and act globally, and that host country nationals should conform their perceptions and behaviors to them. In this scholar's experience, Latin Americans did not appreciate the implied messages this approach communicates.[21]

For example, during an attempt to introduce mediation to Bolivia, host-country advisees "expressed concern that 'the Harvard model' of dispute resolution [was] not directly adaptable" to the resolution of commercial disputes in Bolivia.[22] A similar attempt to introduce mediation in Guatemala gave rise to this anecdote:

> Near the beginning of [the US academic's] first workshop in Guatemala, he provided an overview of American mediation and then demonstrated it by inviting participants to play the spouses in a role play he had written based on a local situation. When he asked for comments after the hour-long demonstration, the first speaker addressed his role playing colleagues and said '[y]ou two looked like *gringos*!'[23]

Even when the basic issue of cultural incompatibility has been identified, much of the existing literature in the area of intercultural negotiation seems to focus on how to avoid offending someone from another culture. Regardless of whether the commentary is based on anecdotal or more systematic evidence, such as Victor's LESCANT model,[24] these attempts to localize U.S.-based approaches to negotiation fail to acknowledge the influence of different legal systems.[25] Almost entirely overlooked in negotiation scholarship is consideration of how differences between legal systems and legal cultures affect negotiation success and resolve the aftermath of failed negotiations.[26]

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20. Menkel-Meadow, *supra* note 6, at 490.

21. Donald C. Peters, *To Sue is Human, to Settle Divine: Intercultural Collaborations to Expand the Use of Mediation in Costa Rica*, 17 FLA. J. INT'L L. 9, 26 (2005).

22. *Id.*

23. *Id.*

24. *See generally* DAVID A. VICTOR, INTERNATIONAL BUSINESS COMMUNICATION (1992). LESCANT is an acronym for Language, Environment and Technology, Social Organization, Contexting, Authority Conception, Nonverbal Behavior and Temporal Conception.

25. Joseph L. Daly, *International Commercial Negotiation and Arbitration*, 22 HAMLINE J. PUB. L. & POL'Y 217, 231–32.

26. *See* JUAN MALARET, MANUAL DE NEGOCIACIÓN Y MEDIACIÓN: NEGOCIACIONES EMPRESARIALES EFICACES PARA JURISTAS Y DIRECTIVOS 156 (2d ed. 2001). Among the few authors to

C. Guidance from Comparative Contract Law

While largely overlooked by negotiation researchers, comparative law scholars working in the area of contract law have examined the legal rights and duties of parties to negotiation in some detail, particularly with regard to pre-contractual liability. Their inquiry centers on whether, during the pre-contractual stage of a negotiation, the parties owe each other a duty of good faith and fair dealing.[27] The answer depends on whether the parties follow the common law or civil law system. While the common law does not impose a general obligation or duty to negotiate in good faith before a contract is formed, [28] the civil law does.[29]

In a common law country like the United States, parties to a negotiation generally do not have a legal duty to act in good faith. This guiding principle is known as "the common law's 'aleatory view' of negotiations."[30] Under this principle, negotiating parties are expected to accept the risk of not reaching an agreement during the negotiation process. "Without a specific desire of the parties for this duty to attach to the negotiation stage, the duty of fair dealing does not extend to the pre-contractual discussions."[31] As a result, good faith obligations generally do not arise until a contract is formed.[32]

The terms *duty of fair dealing* and *duty of good faith* are used interchangeably in much of the literature dealing with pre-contractual negotiations. Professor Farnsworth points out that both terms are paired in the Uniform Commercial Code and the Restatement (Second) of Contracts, and that the "term most commonly used to describe the duty of fair dealing is 'good faith.'"[33]

In the past, some U.S. scholars have debated whether the duty of good faith and fair dealing applies to negotiations that do not lead to contractual agreements.[34] Yet, they concluded that the Uniform Commercial Code ("UCC") and Restatement (Second) of Contracts do not impose these obligations if a

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hint at potentially different interpretations of legal concepts, Malaret stops short of analyzing the fundamental difference between the common law and civil law systems with respect to the obligations imposed on parties to a negotiation. But his analysis is useful because he at least mentions the difficulty in translating legal terms from one language to another when the underlying concepts are understood differently across legal systems, and the fact that differences in legal systems affect negotiations.

27. Friedrich Kessler & Edith Fine, *Culpa in Contrahendo, Bargaining in Good Faith and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401, 404 (1964).

28. E. Allan Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 COLUM. L. REV. 217, 221 (1987).

29. Nadia E. Nedzel, *A Comparative Study of Good Faith, Fair Dealing and Precontractual Liability*, 12 TUL. EUR. & CIV. L.F. 97, 98 (1997).

30. Farnsworth, *supra* note 28, at 221.

31. Neil Boyden Tanner, *Liability for Breaking Off Negotiations: National Report of the United States of America*, Paper presented at Annual Congress of *Association Internationale des Jeunes Avocats*, 5 (2004).

32. Farnsworth, *supra* note 28, at 221.

33. Farnsworth, *supra* note 28, at n.8.

34. Robert S. Adler & Elliot M. Silverstein, *When David Meets Goliath: Dealing with Power Differentials in Negotiations*, 5 HARV. NEGOT. L. REV. 1, 52 (2000).

contract is not made, and "most [U.S.] courts have refused to imply good faith obligations in pre-contractual negotiations."[35]

In the absence of general good faith obligations during pre-contractual negotiations, the U.S. courts have developed various doctrines and mechanisms that moderate the strict common law principle.[36] For example, Professor Farnsworth has determined that a party is able to recover damages based on the other party's wrongful or unjust conduct in pre-contractual stages under the common law concepts of unjust enrichment, misrepresentation, and enforceability of specific promises made during negotiation.[37] While these concepts protect negotiators to some extent under US law,[38] they do not apply to the parties' decisions to cease negotiations when the expected outcomes fall short of their BATNAs.

In contrast to the common law's aleatory view of negotiation, the civil law follows a theory developed by the nineteenth-century German scholar Rudolf von Jhering. This theory viewed negotiators during pre-contractual negotiations as already "linked by a contract-like relationship, based on their factual proximity and the mutual trust resulting out of it. This relationship constitutes contract-like duties, such as a duty to act in good faith. Such duties are enforceable and may give rise to claims in case of violation (*culpa in contrahendo*)."[39]

D. Content of the Duty of Good Faith

What does the duty to negotiate in good faith require parties to do under the civil law? Some scholars contend that the term "good faith" operates as an excluder—that is, as "a phrase without general meaning (or meanings) of its own [which] serves to exclude a wide range of heterogeneous forms of bad faith."[40]

Others attempt to define and clarify the content of the duty to negotiate in good faith. Novoa identifies three main categories of actions: (1) reserve—maintaining the confidentiality of information disclosed in the process of negotiation; (2) custody—taking proper care of property that a party receives during a negotiation; and (3) seriousness—negotiating only if one has a serious

35. *Id.*
36. Farnsworth, *supra* note 28, at 221–22.
37. *Id.* at 222.
38. *Id.*
39. Marcel R. Ruygvoorn & Clais Baron v. Mirbach, *Liability for Breaking Off Negotiations: General Report for the Working Session of the Business Law Committee*, Paper presented at Annual Congress of *Association Internationale des Jeunes Avocats*, 5 (2004).
40. Robert S. Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 201 (1968).

intent to make an agreement and ceasing to negotiate at once when such intent is no longer present.[41]

From the perspective of Spanish law, García Rubio identifies a duty of loyalty as inherent in the concept of good faith. During the pre-contractual period, this duty requires that the other party be notified if negotiations are carried on with third parties, or at least that negotiations with third parties are not concealed during the pre-contractual period.[42]

Other authors interpret good faith as requiring negotiators to tell the truth when making statements during negotiations. The duty of candor, which also exists in the United States, is the obligation to refrain from making false statements during the negotiations. This obligation is policed by principles of contract and tort law (warranty, misrepresentation, fraud) and can hold parties liable in damages or subject to other legal and/or equitable remedies. Furthermore, rules of professional conduct, such as those applicable to lawyers, may prohibit parties' agents from making of false or misleading statements during negotiation.[43]

E. Civil Law: Can You Simply Walk Away?

Absent the special circumstances outlined by Professor Farnsworth as discussed above,[44] the common law's traditional aleatory view of negotiation permits parties to generally walk away from the bargaining table at any time. In contrast to the common law view of negotiation, the civil law approach prohibits negotiators from simply walking away from a negotiation without just cause after a certain threshold has been passed. For example, a party may be liable for breaking off negotiations if the other party has been induced to reasonably rely on the imminent making of a contract and there is no just cause for breaking the negotiations.

However, the precise nature and extent of the obligation to negotiate in good faith vary from country to country within the civil law world. In some jurisdictions, this includes a duty not to negotiate with a third person until post-deal negotiations with a party in the original transaction have failed. In other areas, the duty of good faith imposes an obligation not to terminate negotiations

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41. Rodrigo Novoa, *Culpa in Contrahendo: A Comparative Law Study: Chilean Law and the United Nations Convention on Contracts for the International Sales of Goods (CISG)*, 22 ARIZ. J. INT'L & COMP. L. 583, 593 (2005).

42. MA PAZ GARCÍA RUBIO, LA RESPONSABILIDAD PRECONTRACTUAL EN EL DERECHO ESPAÑOL 55 (1991) (*"lo que sí parece exigir la lealtad debida en el período precontractual es dar noticia a la otra parte de que se siguen negociaciones con terceros, o, al menos, no ocultar este dato"*).

43. Geoffrey C. Hazard, Jr., *The Lawyer's Obligation to be Trustworthy When Dealing with Opposing Parties*, *in* WHAT'S FAIR: ETHICS FOR NEGOTIATORS 168 (Carrie Menkel-Meadow & Michael Wheeler, eds., 2004).

44. Farnsworth, *supra* note 28.

without reasonable cause and without having persevered for a reasonable length of time.[45]

Rubio concludes that Spanish law finds the following conduct improper: (1) beginning negotiations with a specific purpose to withdraw from them, or extending the negotiations beyond a certain point with the purpose to subsequently withdraw (whether to cause harm or obtain information); or (2) leading the other party to believe that the possibility of contracting is stronger than it actually is, but subsequently withdrawing from negotiations for frivolous reasons.[46] Note that under Spanish law, the parties are not obliged to enter into the contract, but instead are only required to use proper and loyal conduct in the negotiation.[47]

If bad faith exists, the Spanish Supreme Court interprets Spanish Civil Code Article 1902 to impose tort liability.[48] However, Spanish law allows withdrawal from negotiation when the withdrawing party has the chance at a better deal elsewhere.[49] In other words, "withdrawal from the negotiation in itself is not punishable. There must have been something unlawful in it, such as . . . not having the intention of reaching an agreement, or continuing the negotiation after realizing that a final agreement cannot be reached."[50]

F. Walking Away to BATNA Under Civil Law

Under the foregoing structure, there is a clear conflict between the common law-inspired negotiation strategy, which does not usually impose liability on parties who walk away during negotiations, and the civil law approach, which restricts a party's ability to withdraw from negotiations without just cause. The concept of BATNA is the most prominent example of this conflict. In contrast to the civil law theory, the U.S. theory enables a negotiator to walk away from the negotiation to a better BATNA offered by a third party without needing just cause.

Roger Fisher and William Ury coined the term BATNA around the time that *Getting to Yes* was published and it became a fundamental part of the jargon of negotiation, as well as a main component of many U.S.-based negotiation methods. William Ury once remarked that "if we got a nickel every time someone uses our word BATNA, we'd be rich."[51] In general, awareness of one's own BATNA helps in determining whether and when it is best to break off a

45. Jeswald W. Salacuse, *Renegotiating International Project Agreements*, 24 FORDHAM INT'L L. J. 1319, 1323 (2001).

46. However, Spanish commentators are divided as to whether mere frivolous or groundless termination of negotiations may give rise to liability. GARCÍA RUBIO, *supra* note 42, at 130–31.

47. GARCÍA RUBIO, *supra* note 42, at 130.

48. STS, Dec. 16, 1999 (ROJ, No. 8109/1999); STS, May 16, 1988 (ROJ, No. 3673/1988).

49. GARCÍA RUBIO, *supra* note 42, at 133–34.

50. Novoa, *supra* note 41, at 594.

51. Wheeler & Waters, *supra* note 7, at 481.

negotiation.[52] Additionally, BATNA may be used as a sword instead of a shield because "if a negotiator has a strong BATNA, he or she may confront the other side with it, threatening to walk away unless the last offer is accepted."[53]

BATNA is a standard of measurement against which the proposed outcome of each particular negotiation must be measured to determine whether a deal should be accepted. In other words, the proposed outcome of a particular negotiation must be at least as good as one's BATNA. If the proposed outcome is not at least as good, negotiators are advised to abandon the negotiation:

- As a last resort, turn to your BATNA (your Best Alternative to a Negotiated Agreement) and walk out.[54]
- You can always walk to your BATNA.[55]
- Any viable BATNA gives the negotiator the choice to walk away from the current deal . . . .[56]
- Don't be hesitant about calling it quits . . . there will come a time when you simply have to get up and walk away . . . .[57]

As demonstrated by the foregoing points, the concept of BATNA is indeed valuable in determining when to call off the negotiation. Under the traditional common law approach, negotiators only had to consider their own interests in deciding whether to walk away from a negotiation. In contrast, under the civil law approach, the duty of good faith and fair dealing in the negotiation stage requires negotiators to consider not only their own interests, but also interests of the other party when deciding whether to abandon the negotiation in favor of their BATNA.

At a minimum, the other party's reliance interests must be considered when terminating a negotiation. According to von Jhering's original formulation, it is well settled that the primary goal of the doctrine of *culpa in contrahendo* is to "provide for the restoration of the *status quo* by giving the injured party his 'negative interest' or reliance damages."[58] In some instances, reasonable expectation and restitution interests must also be considered. However, recovery for expectation interests in a failed negotiation is problematic because it is more difficult to determine the benefit of a bargain that was not made.[59]

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52. STEVEN COHEN & RICARDO ALTIMIRA, CLAVES DE NEGOCIACIÓN . . . CON EL CORAZÓN Y LA MENTE 25 (2003).
53. FISHER, PATTON & URY, *supra* note 1, at 193.
54. *Id.* at 134.
55. ROBERT H. MNOOKIN, ET AL., BEYOND WINNING: NEGOTIATING TO CREATE VALUE IN DEALS AND DISPUTES 220 (2000).
56. ROY J. LEWICKI ET AL., NEGOTIATION 200 (5th int'l. ed. 2006).
57. GEORGE FULLER, THE NEGOTIATOR'S HANDBOOK 253 (1991).
58. Kessler & Fine, *supra* note 27, at 402.
59. Farnsworth, *supra* note 28, at 223.

In the case of reliance damages, the amount of recovery centers on what kinds of harm may be considered to fall under the broad category of reliance. On the one hand, it is clear that any reasonable out-of-pocket expenses and any worsening in the injured party's situation should count towards the damages. On the other hand, it is not clear whether lost opportunities previously available to the injured party should be counted in reliance.[60]

Delegates to the 2004 Naples meeting of the International Association of Young Lawyers (*Association Internationale des Jeunes Avocats* or "AIJA") examined the issue of liability for withdrawing from negotiations during the pre-contractual stage. An analysis of the National Reports prepared by AIJA delegates, including those from Austria, Belgium, Brazil, Denmark, Finland, Germany, Italy, and Switzerland, reveals that as a general rule, the non-withdrawing party may recover damages based on their reliance that a contract would be forthcoming from a particular negotiation. Thus out-of-pocket expenses, costs incurred in preparing to perform the expected contract, and damages for opportunities lost as a result of this reliance are generally recoverable.[61]

Some jurisdictions within the civil law system have considered other grounds for remedies. Under Austrian law, for example, specific performance is not granted unless the withdrawing party is otherwise under a legal duty to enter into the contract.[62] In Belgium, a party could be compelled to continue negotiating, although tort damages are the preferred remedy.[63] Under Swiss law, in a few situations, a party may be compelled to return to a failed negotiation and even enter into a contract. These situations include negotiations involving public utilities, transportation and antitrust matters, where public law imposes an affirmative duty to do so.[64] In addition to reliance damages, Danish law allows the possibility of claiming for "unlawful enrichment" obtained by the party who

60. Farnsworth, *supra* note 28, at 225. Recovery for expectation interests under U.S. law will be discussed further in Part II.

61. *See* Stefan Korab, *Liability for Breaking Off Negotiations: National Report of Austria*, Paper presented at Annual Congress of *Association Internationale des Jeunes Avocats*, 9 (2004); Louis Verstraeten, *Breaking Off Negotiations: National Report of Belgium*, Paper presented at Annual Congress of *Association Internationale des Jeunes Avocats*, 10 (2004); Carla Junqueira, *Liability for Breaking-off Negotiations: National Report of Brazil*, Paper presented at Annual Congress of *Association Internationale des Jeunes Avocats*, 5 (2004); Sanna Suvanto, *Liability for Breaking-off Negotiations: National Report of Finland*, Paper presented at Annual Congress of *Association Internationale des Jeunes Avocats*, 7 (2004); Christoph Close, *Liability for Breaking-off Negotiations: National Report of Germany*, Paper presented at Annual Congress of *Association Internationale des Jeunes Avocats*, 15 (2004); Roberto Luzi Crivellini, *Liability for Breaking-off Negotiations: National Report of Italy*, Paper presented at Annual Congress of *Association Internationale des Jeunes Avocats*, 29 (2004); Niloo Verma, *Liability for Breaking-off Negotiations: National Report of Switzerland*, Paper presented at Annual Congress of *Association Internationale des Jeunes Avocats*, 8, 11 (2004); Christian Lundgren, *Liability for Breaking-off Negotiations: National Report of Denmark*, Paper presented at Annual Congress of *Association Internationale des Jeunes Avocats*, 6–7 (2004).

62. Korab, *supra* note 61.

63. Verstraeten, *supra* note 61.

64. Verma, *supra* note 61.

withdrew from the negotiation.[65] Under German law, in extraordinary circumstances, parties can be compelled to continue negotiating or enter into a contract (but the latter would only occur if a contract were complete in all essential elements and lacking only completion of missing terms by the court).[66] One commentator, in an article analyzing *obiter dicta* in a decision of Israel's Court of Appeals, acknowledged at least the potential for specific performance that would push the envelope to the conceivable extreme of forcing the withdrawing party to enter into a contract that it originally rejected during the negotiation itself.[67]

However, these additional remedies are rare. Usually, the standard measure of recovery in cases involving the unjustified termination of negotiations is based on the reliance interest of the non-withdrawing party. As a result, to circumscribe the reliance interest, negotiation practitioners should be encouraged to manage the other party's expectations. This might be done in the early stages of the negotiation process, when setting ground rules for the negotiation and spelling out clearly what the parties may rely upon during the negotiation and afterward if a final agreement is not reached.

Considering once more the spectrum of responses received in the National Reports at the 2004 AIJA conference, most legal systems allow negotiating parties to limit reliance of the other side by entering into prior agreements. Under Austrian law, for example, "[i]n order to avoid liability for breaking off negotiations, the parties can agree to reserve their right to break off negotiations at any time . . . . It would even be sufficient to unilaterally declare to reserve the right to stop negotiations . . . ."[68] However, such an agreement or declaration would not shield from liability a withdrawing party who acted with intent, recklessness, or gross negligence.[69] Belgian law also allows parties to avoid liability for breaking off negotiations, but requires the written agreement of both parties instead of a mere unilateral declaration.[70]

Excluding liability for termination of negotiations is based on the standard of reasonable reliance[71] and the premise that reliance is unreasonable when an express disclaimer has been established by one or both parties at the outset, as part of the ground rules for their negotiation. For example, a statement that "all negotiations with us are on a non-exclusive basis unless expressly stated otherwise in writing" would make it difficult for the other party to reasonably

65. Lundgren, *supra* note 61, at 7.

66. Close, *supra* note 61.

67. Sylviane Colombo, *The Present Differences Between the Civil Law and Common Law Worlds with Regard to Culpa In Contrahendo*, 2 TILBURG FOREIGN L. REV. 341, 367 (1993).

68. Korab, *supra* note 61, at 11.

69. *Id.*

70. Verstraeten, *supra* note 61, at 13–14.

71. RESTATEMENT (SECOND) OF CONTRACTS § 90 (Am. Law Inst. 1981).

rely on a purported impression that the negotiation was being conducted on an exclusive basis.

II. NEGOTIATION STRATEGY IN THE UNITED STATES: COMPLICATIONS WITH BATNA STRATEGY

As noted in Part I, civil law systems impose a duty to negotiate in good faith, which might limit the parties' ability to employ a BATNA strategy that leads them to terminate negotiations when their alternatives are better than the deal under consideration. This good faith duty generally does not exist in common law systems. Part II now examines in greater detail the duty in a common law system—the United States—by focusing on a case that illustrates the severe consequences that can arise when a negotiator relies too heavily on the general U.S. rule.

A. The Duty to Negotiate in Good Faith in the United States

Professor Jeffries has provided a useful summary of the U.S. approach to the question of whether there is an obligation to negotiate in good faith. Jeffries begins by distinguishing between contract performance and contract formation. There is a duty to perform a contract in good faith and fair dealing, but not a general duty to negotiate a contract in good faith.[72] In other words, negotiators in the United States run the risk "that the other party will terminate the discussions and walk away in bad faith, leaving the disappointed party without a remedy."[73]

However, Jeffries notes an important exception to the U.S. approach in that "most jurisdictions recognize that parties can *contractually* obligate themselves to such a duty."[74] For example, a letter of intent that states the parties' "mutual intent to negotiate in good faith to enter into a definitive Agreement," will impose the duty to negotiate in good faith on both parties.[75] By the same logic, the parties can expressly disclaim a duty to negotiate in good faith. According to Jeffries,

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72. Browning Jeffries, *Preliminary Negotiations or Binding Obligations? A Framework for Determining the Intent of the Parties*, 48 GONZ. L. REV. 1, 13, nn.55–56 (2012).

73. *Id.* at 14 n.60.

74. *Id.* at 15 n.61. Other exceptions apply in more limited situations, such as National Labor Relations Act and Federal Truth in Lending Act provisions that impose a duty to negotiate in good faith. *Id.* at 9–10 n.57. Another exception is that in some states there might be an implied duty to negotiate in good faith as a result of a binding exclusivity clause. *See* Douglas Warner, *Good Faith: The New Frontier of Agreements to Negotiate*, HARV. LAW SCH. F. ON CORP. GOVERNANCE & FIN. REG., (July 3, 2013), http://corpgov.law.harvard.edu/2013/07/03/good-faith-the-new-frontier-of-agreements-to-negotiate/ (discussing EQT Infrastructure Ltd. v. Smith, 861 F. Supp. 2d 220 (S.D.N.Y. 2012)).

75. Jeffries, *supra* note 72, at 15.

"a court would also enforce clear language in a preliminary agreement disclaiming any duty to negotiate in good faith."[76]

Jeffries further notes that remedies for breaching a commitment to negotiate in good faith are generally limited to reliance damages, injunctive relief, or specific performance: "Generally, courts hold that a party cannot recover expectation or benefit-of-the-bargain damages because the agreement does not guarantee that the parties will ultimately conclude the final contract."[77]

On the surface, this summary of U.S. law appears to be fairly straightforward, providing clear guidance to negotiators. A negotiator who wants the other side to commit to negotiation in good faith should include such an obligation in a preliminary agreement.[78] Negotiators who do not want to be bound by a duty to negotiate in good faith are not required to include the duty in a preliminary agreement; although to be on the safe side, a party could disclaim the duty in the agreement. And remedies for breach of an agreement to negotiate in good faith are limited.

Given the complexity of business negotiations, however, the overall generalizations in Jefferies' summary can be misleading. A case in point is the decision by the Delaware Supreme Court in *SIGA Technologies, Inc. v. PharmAthene, Inc*. ("*SIGA II*"),[79] which provides a dramatic example of the dangers in relying on generalizations. In *SIGA II*, the court based its finding of defendant's liability on "Non-Binding Terms," and, at one point, defendant's liability appeared to have exceeded $1 billion. The case is also significant because of the importance of Delaware law in the business world.

SIGA II illustrates a sequence of events that is common in business negotiations. This sequence begins with negotiations between the parties. At some point during the negotiations, the parties might decide to negotiate a framework agreement. These agreements go by a variety of names: letter of intent, memorandum of understanding, term sheet, commitment letter, preliminary agreement, agreement in principle, memorandum of agreement, and so on. Even emails can create framework agreements.[80] Framework agreements are especially useful in auction settings to "protect against unserious bidders or fickle sellers."[81] More generally, as noted in *Getting to Yes*, drafting possible

76. *Id.* at 15 n.64.

77. *Id.* at 18 n.71.

78. However, not all states will enforce agreements to negotiate. *See infra* note 153.

79. SIGA Techs., Inc. v. PharmAthene Inc. (*SIGA II*), 132 A.3d 1108 (Del. 2015).

80. Benton B. Bodamer & Kevin J. Sullivan, *CYA On That LOI: Avoiding Liability Under Preliminary Agreements*, THE METRO. CORP. COUNS. (Feb. 24, 2012), http://www.metrocorpcounsel.com/articles/17975/cya-loi-avoiding-liability-under-preliminary-agreements.

81. Brian Bouggy, *Letters of Intent and Covenants to Negotiate in Good Faith*, DENSBORN BLACHLY, LLP (Oct. 31, 2013), http://densbornblachly.com/letters-of-intent-and-covenants-to-negotiate-in-good-faith/; *see* Masood Sohaili, *Delaware Decision Opens Door to Enforcement of Term Sheets*, DLA PIPER,

contract terms "helps to keep discussions focused, tends to surface important issues that might otherwise be overlooked, and gives a sense of progress."[82] The authors caution that negotiators should write into their framework agreements: "Tentative Draft — No Commitments."[83] However, letters of intent and other framework agreements often include some binding provisions such as a confidentiality clause and an exclusivity period under which a seller, for example, might agree not to negotiate with other parties during a specified time period.[84]

Framework agreements create legal complications when one party wants to back out of the deal in bad faith and the other party claims either that the framework agreement was detailed enough to constitute a binding contract or that the agreement obligated the parties to negotiate in good faith. *SIGA II* illustrates the latter situation.

B. The Negotiation Process in SIGA II

Plaintiff PharmAthene, Inc. and defendant SIGA Technologies, Inc. are Delaware corporations involved in biodefense research and development. The following is a simplified version of their negotiations, drawn from two Delaware Supreme Court decisions: SIGA Technologies, Inc. v. PharmAthene Inc. ("*SIGA I*")[85] and *SIGA II.*

- **2004:** Defendant acquired a drug for treatment of smallpox (ST-246). Although the drug had "enormous potential," there was uncertainty about its viability, uses and safety.[86]
- **Late 2005:** Because defendant faced financial problems and needed around $16 million to develop the drug, its management began discussing collaboration with plaintiff. Plaintiff wanted to merge with defendant, but defendant wanted a license agreement before discussing a merger. Both parties valued the smallpox drug at around $1 billion.[87]
- **January 3, 2006:** Plaintiff sent defendant a proposed license agreement term sheet ("LATS").[88]

(June 6, 2013), https://www.dlapiper.com/en/us/insights/publications/2013/06/delaware-decision-opens-door-to-enforcement-of-t__/.

82. FISHER, PATTON & URY, *supra* note 1, at 172.

83. *Id.*

84. Jeffries, *supra* note 72, at 8 n.77. *Delaware Supreme Court Finds Binding Commitment to Negotiate Agreement in Good Faith Obligates Parties to Negotiate Substantially in Accordance with Term Sheet*, WINSTON & STRAWN, LLP, (June 2013), http://www.winston.com/images/content/1/5/1566.pdf.

85. 67 A.3d 330 (Del. 2013).

86. *Id.* at 334.

87. *Id.*

88. *Id.* at 335.

- **January 16, 2006**: After exchanging draft term sheets, plaintiff sent defendant a revised term sheet for a $16 million deal with a $6 million payment upfront.[89]
- **January 19, 2006:** After defendant requested revisions, plaintiff approved a revised LATS.[90]
- **January 23, 2006:** Because plaintiff preferred a merger over a license agreement, the parties met to start merger negotiations. Defendant asked plaintiff for a bridge loan to finance continuing development of the drug while these negotiations were in progress.[91]
- **January 26, 2006:** A clean copy of the two-page LATS was drafted, which was not signed and stated at the bottom of each page: "Non-Binding Terms." The LATS provided that defendant would give plaintiff a worldwide exclusive license to use, develop, make and sell the smallpox drug in exchange for a $6 million license fee, an additional $10 million when certain milestones were achieved, and an annual royalty. Plaintiff also agreed to make additional payments based on sales to the United States government.[92]
- **February 10, 2006:** Plaintiff sent defendant a draft merger term sheet, which provided that the parties would negotiate the license agreement, and it would become effective only if the merger deal did not close.[93]
- **March 10, 2006:** Plaintiff and defendant signed a merger letter of intent, to which they attached the merger term sheet and the LATS. The lower court found that prior to executing this document, defendant's Chairman of the Board of Directors advised plaintiff that "if the merger doesn't close, [PharmAthene] will get [its] license."[94]
- **March 20, 2006:** The parties entered into a Bridge Loan Agreement whereby plaintiff agreed to lend $3 million to defendant for development of the drug and other expenses. The agreement specified that, if the merger talks terminated, the parties would "negotiate in good faith with the intention of executing a definitive License Agreement" according to the terms in the LATS. The Bridge Loan Agreement was governed by New York law, instead of Delaware corporate law.[95]

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89. *Id.*
90. *Id.*
91. *Id.*
92. *Id.* at 336.
93. *Id.*
94. *Id.* at 337.
95. *Id.* at 337–38.

- **June 8, 2006:** The parties signed a merger agreement that was governed by Delaware law. The agreement included a good faith agreement similar to the clause in the Bridge Loan Agreement and a drop-dead date of September 30, 2006.[96]
- **September, 2006:** The defendant expressed remorse after receiving a $16.5 million award from the National Institutes of Health to develop the drug.[97]
- **October 4, 2006:** After plaintiff asked defendant to extend the drop-dead date in the June 8, 2006 merger agreement, defendant's Board of Directors voted to terminate the merger agreement. Shortly thereafter, defendant announced the $16.5 million grant and that the drug "provided 100% protection against smallpox in a primate trial."[98] Defendant then sold two million shares of stock for three times its 2005 share price. Although not framed this way by the court, under negotiation theory, defendant's BATNA had strengthened considerably, leading to improvement in its bargaining power.
- **October 26, 2006:** Plaintiff sent defendant a proposed licensing agreement. An attorney for defendant responded that the negotiations required a "robust discussion."
- **November 6, 2006:** At a meeting to discuss the license agreement, defendant "proposed a $40–45 million upfront payment and a 50-50 profit split."[99]
- **November 21, 2006:** Defendant sent plaintiff a 102-page draft LLC agreement. According to the trial court, when compared to the LATS: (1) the draft increased the plaintiff's upfront payment from $6 million to $100 million, (2) milestone payments owed defendant increased from $10 million to $235 million, and (3) royalty payments owed defendant increased substantially. Defendant also revised several other provisions in its favor.[100] In negotiation terminology, defendant was exercising its newfound BATNA power in this phase of the negotiations.
- **November 27–28, 2006:** Several emails indicated that SIGA's internal valuation of the drug was somewhere between $3 billion and $5.6 billion.[101]

96. *Id.* at 338.
97. *Id.*
98. *Id.* at 339.
99. *Id.*
100. *Id.*
101. SIGA Techs., Inc. v. PharmAthene Inc. (*SIGA II*), 132 A.3d 1108, 1113–16 (Del. 2015).

- **December 12, 2006:** Following an exchange of letters between the parties in which defendant argued that the LATS was not binding because of the "Non-Binding Terms" language at the bottom of each page, defendant issued an ultimatum that plaintiff had to respond by December 20 indicating that it was prepared to negotiate "without conditions." Otherwise, the parties had "nothing more to talk about."[102]
- **December 20, 2006:** Plaintiff filed suit in the Delaware Court of Chancery.

C. The Delaware Supreme Court Decision in SIGA I

Following an eleven-day trial in January 2011, the Vice Chancellor applied Delaware law and found that defendant was liable for damages under two theories: (1) for breaching its obligation to negotiate in good faith under the March 20, 2006 Bridge Loan Agreement and the June 8, 2006 merger agreement; and (2) under the doctrine of promissory estoppel. The Vice Chancellor held that the parties did agree to the license agreement and that plaintiff was entitled to payment roughly equal to the terms of that agreement.[103] The defendant appealed this decision to the Delaware Supreme Court and the plaintiff cross-appealed.

In an *en banc* decision on May 24, 2013, the court reviewed most of the Vice Chancellor's decision *de novo*.[104] The court's analysis focused on two main issues: (1) whether the defendant had a duty to negotiate in good faith and had breached such duty; and (2) if so, what would be the proper remedy. The court concluded that SIGA had acted in bad faith in breaching its duty to negotiate the licensing agreement. The court also reversed the Vice Chancellor's decision that SIGA was liable on a promissory estoppel theory, and remanded the case for a determination of damages.

1. The Defendant's Obligation to Negotiate in Good Faith

The defendant presented several reasons why it did not breach an obligation to negotiate in good faith. First, it would be inconsistent to decide that the LATS was not a binding agreement while also contending that the defendant could "only propose terms substantially similar to the LATS."[105] Second, the fact that the plaintiff was willing to accept terms substantially different from the LATS

102. *SIGA I*, 67 A.3d at 340.

103. *Id.* at 349.

104. *Id.* at 343. The Bridge Loan Agreement and merger agreement both imposed an obligation to negotiate in good faith but had competing choice of law clauses. The court affirmed the Vice Chancellor's decision to apply Delaware law because the merger agreement was later in time and "encompassed the activity that lay at the heart of this case."

105. *Id.*

showed that the defendant had the right to propose different terms.[106] Finally, "dangerous uncertainty" in the law would result from requiring the defendant to propose only terms substantially similar to the LATS because the degree of variance between the LATS and the later offer is "indefinable."[107]

The court rejected these arguments and concluded that the defendant had violated its obligation to negotiate in good faith. In so doing, the court reaffirmed an earlier decision that "an express contractual obligation to negotiate in good faith is binding on the contracting parties."[108] Thus, Delaware is aligned with the approach adopted by a majority of U.S. courts,[109] where the parties' intention determines whether a good-faith duty to negotiate has been created.

Applying this rule to the facts in this case, the court noted that the parties were obligated to "negotiate in good faith with the intention of executing" a license agreement according to the terms in the LATS. This obligation was created by language in both the March 20, 2006 Bridge Loan Agreement and the June 8, 2006 merger agreement that, according to the court, trumped the "Non-Binding Terms" footers on each page of the earlier (January 26, 2006) LATS.

But does this mean that the deal had to be substantially similar to, or not inconsistent with, the LATS? Or was the LATS simply a "jumping off point" for further negotiations (as noted by the Chairman of defendant's Board of Directors)? In answering this question, the court decided that the record supported the Vice Chancellor's conclusion that the parties intended to negotiate a license agreement substantially similar to the LATS. The Vice Chancellor had concluded that, contrary to the parties' earlier intentions, the defendant later "virtually disregarded the economic terms of the LATS"[110] when drafting the 2006 LLC agreement.

The court emphasized that substantial dissimilarity by itself is not enough to prove a lack of good faith; there must also be evidence that a party proposed the terms in bad faith. Bad faith is defined as "not simply bad judgment or negligence, but rather it implies the conscious doing of a wrong because of dishonest purpose or moral obliquity . . . ."[111] In concluding that the Vice Chancellor correctly decided that the defendant acted in bad faith, the court noted that among other factors, the defendant experienced "'seller's remorse' during the merger negotiations for having given up control of what was looking more and more like a multi-billion dollar drug."[112] In support, the court mentioned, a message from the defendant's Chief Financial Officer telling its Chief Scientific

106. *Id.* at 343 n.41.
107. *Id.*
108. *Id.* at 343–44.
109. *See supra* note 74 and accompanying text.
110. *SIGA I*, 67 A.3d at 346.
111. *Id.*
112. *Id.* at 347.

Officer, "it's a damn shame we had to merge." The Chief Scientific Officer's responded, "You got that right . . . . Had [the former CEO of SIGA] not gotten us behind the curve through ineptitude, we would still be an independent company and standing to make some real dough . . . we could have gone all the way ourselves."[113]

Having decided that in their Bridge Loan Agreement and merger agreement the parties had created a duty to negotiate in good faith and that the defendant had violated this duty by disregarding the terms of the LATS, the court then had to ascertain an appropriate remedy.

2. The Appropriate Remedy

In selecting an appropriate remedy, the court initially decided that promissory estoppel did not apply in this situation because there was an express promise to negotiate in good faith. Instead, the court framed the remedy question as a search for "the proper contractual remedy for breach of an agreement to negotiate in good faith where the court finds as fact that the parties, had they negotiated in good faith, would have reached an agreement."[114] In addressing this question, the court turned to the federal court interpretation of New York law for guidance after noting that the answer was unclear under Delaware law.[115] The court noted that federal courts distinguish between two types of agreements: a "Type I" agreement and a "Type II" agreement.

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."[116] A Type II agreement arises when the parties "agree on certain major terms, but leave other terms open for further negotiations."[117] This type of agreement creates an "obligation to negotiate the open issues in good faith in an attempt to reach the alternate objective within the agreed framework" without committing the parties to their "ultimate contractual objective.[118]

The *SIGA I* court acknowledged that other courts have been reluctant to award expectation damages. For instance, the New York Court of Appeals has held that plaintiffs are limited to reliance damages when a defendant breaches an agreement to negotiate[119] and in *Fairbrook Leasing, Inc. v. Mesaba Aviation,*

113. *Id.* at 353 n.70.

114. *Id.* at 348.

115. *Id.* at 343–44. The court noted, however, that its choice of law decision to apply Delaware law "mandates that we apply Delaware law." *Id.* at 349.

116. *Id.* at 353 n.82 (quoting Adjustrite Sys., Inc. v. GAB Bus. Servs., Inc., 145 F.3d 543, 548 (2d Cir. 1998)).

117. *Id.* at 349 (quoting *Adjustrite*, 145 F.3d at 548).

118. *Id.* (citing Teachers Ins. & Annuity Ass'n. of Am. v. Tribune Co., 670 F.Supp. 491, 498 (S.D.N.Y. 1987)).

119. *Id.* (citing Goodstein Constr. Corp. v. City of N.Y., 80 N.Y.2d 366, 372 (1992)).

Inc., the Eighth Circuit Court of Appeals held that this rule applies to Type II agreements. As quoted by the *SIGA I* court, the court in *Fairbrook* decided that: "New York's intermediate appellate courts have [read case precedent] as categorically precluding expecta[tion] damages for breach of a [Type II] binding preliminary agreement to negotiate a final agreement in good faith."[120] However, the *Fairbrook* court also expressed doubt over whether this holding would apply in situations where a judge could use objective criteria to fill in missing terms.[121]

As noted earlier,[122] most courts in the United States are reluctant to award expectation damages for breach of an agreement to negotiate in good faith. However, based on the doubt noted in *Fairbrook*, coupled with Judge Posner's majority opinion in a Seventh Circuit Court of Appeals decision,[123] the Delaware Supreme Court decided that "where the parties have a Type II preliminary agreement to negotiate in good faith, and the trial judge makes a factual finding, supported by the record, that the parties would have reached an agreement but for the defendant's bad faith negotiations, the plaintiff is entitled to recover contract expectation damages."[124] Applying this holding to the facts in *SIGA I*, the court decided that the parties had entered into a Type II agreement of the sort that enables a party to recover expectation damages and remanded the case for determination of the damages.[125]

D. On Remand Following SIGA I: The Billion Dollar Question

On remand following the Delaware Supreme Court's May 24, 2013 *SIGA I* decision, the Vice Chancellor issued a Memorandum Opinion on August 8, 2014 concluding that plaintiff was entitled to "an award of expectation damages in the form of a lump sum for lost profits."[126] Although plaintiff's expert calculated its damages as $1.07 billion under the LATS based on facts known as of December 20, 2006,[127] the Vice Chancellor decided that several modifications to the expert's model were necessary and ordered the parties to cooperate in preparing

120. *Id.* (quoting Fairbrook Leasing, Inc. v. Mesaba Aviation, Inc., 519 F.3d 421, 428 n.7 (8th Cir. 2008)).

121. *Id.*

122. *See supra* note 77 and accompanying text.

123. *SIGA I*, 67 A.3d at 350 n.96 (citing Venture Assocs. Corp. v. Zenith Data Sys. Corp., 96 F.3d 275, 278 (7th Cir. 1996)).

124. *Id.* at 350–51.

125. *Id*. at 351. At least one federal court and one state court of appeals have allowed benefit of the bargain damages. Warner, *supra* note 74; *see* Network Enters., Inc. v. APBA Offshore Prods., 427 F. Supp. 2d 463 (S.D.N.Y 2006); *and* Colum. Park Golf Course, Inc. v. City of Kennewick, No. 28357-7-III (Wash. Ct. App. 2011).

126. PharmAthene, Inc. v. SIGA Techs., Inc., 2014 WL 3974167, at * 1 (Del. Ch. Aug. 8, 2014).

127. *Id.* at *9. The expert used a model prepared by the plaintiff in early 2006, which it shared with (and was apparently used by) the defendant. The model estimated sales to the U.S. and other governments over a ten-year period, then subtracted the plaintiff's estimated costs, and used a probability of success factor of 84%, which was the probability of achieving federal government approval, to risk-adjust the earnings. The expert then used a discount rate of 23.1% to determine the net present value of the plaintiff's lost profits. *Id.* at *10.

and submitting a form for the final judgment.[128] Following the August 8 decision, defendant's stock dropped 39%, the largest single-day drop in almost three years, while plaintiff's stock increased 43%, the largest one-day gain in almost four years.[129]

On September 16, 2014, the defendant filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code.[130] According to the defendant's CEO, the filing was triggered by its inability to post a bond to appeal the August 8 ruling.

> In light of [SIGA's] inability to bond the judgment, only the automatic stay provisions under the Bankruptcy Code can prevent PharmAthene from immediately enforcing the Court of Chancery's judgment, executing on [SIGA's] assets, seizing its bank accounts and effectively freezing [SIGA's] operations—thus depriving the nation of an important drug and depriving [SIGA] of the opportunity to pursue its appeal.[131]

The filing caused plaintiff's stock to drop by 13%.[132]

On January 7, 2015, the Chancery Court issued a Letter Opinion in which it adjusted a revised damages calculation submitted by plaintiff's expert.[133] This was followed, on January 15, 2015, by a Chancery Court order requiring the defendant to pay the plaintiff expectation damages of $113 million and pre-judgment interest of $78 million on those damages. Combined with legal fees, costs, and expenses, the bill totaled close to $195 million plus post-judgment interest of $30,664 per day.[134] On January 16, 2015, the defendant appealed the damage award and the plaintiff cross-appealed on January 30, 2015.[135]

On March 9, 2015, while the appeal was pending, the plaintiff's Board of Directors approved a plan to eliminate two-thirds of its workforce to preserve

128. *Id*. at *20.

129. Jeff Feeley, *PharmAthene May Get $500 Million From Smallpox Drug Sales*, BLOOMBERG (Aug. 12, 2014), http://www.bloomberg.com/news/articles/2014-08-11/pharmathene-to-share-up-to-500-million-in-smallpox-drug-profits.

130. SIGA Techs., Inc., Quarterly Report (Form 10-Q), at 6 (May 6, 2015), *available at* http://investor.siga.com/secfiling.cfm?filingID=1010086-15-8&CIK=1010086 [hereinafter "SIGA Quarterly Report"].

131. Affidavit of Eric A. Rose, ECF No. 3, at ¶ 4, *In re* SIGA Techs., No. 1:14-BK-12623 (Bankr. S.D.N.Y. Sept. 16, 2014).

132. Bob Cramer, *PharmAthene Plunges After SIGA Technologies Files for Chapter 11 Bankruptcy*, BIDNESS ETC, (Sept. 16, 2014), http://www.bidnessetc.com/25718-pharmathene-plunges-after-siga-technologies-files-for-chapter-11-bankruptcy/.

133. Re: PharmAthene, Inc. v. SIGA Techs., Inc., 2015 WL 98901, at*1–2 (Del. Ch. Jan. 7, 2015).

134. PharmAthene, Inc. v. SIGA Techs., Inc., No. 2627-VCP, 1, 3 (Del. Ch. 2014) (final order and judgment), *available at* http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=5&ved=0CDcQFjAE&url=http%3A%2F%2Fphx.corporate-ir.net%2FExternal.File%3Fitem%3DUGFyZW50SUQ9MjY3MDY0fENoaWxkSUQ9LTF8VHlwZT0z%26t%3D1&ei=1vJVVd-0EsmAywOe9IH4Bg&usg=AFQjCNH1cBtPWFiJIwRHrDVvMwL1_jgUyg&bvm=bv.93564037,d.bGQ.

135. SIGA Quarterly Report, *supra* note 130, at 6.

cash sufficient to finance continuing operations through the appeal.[136] And on March 18, 2015, the defendant received a delisting notice from the NASDAQ Stock Market.[137]

E. The Final Decision: SIGA II

In an opinion dated December 23, 2015 (virtually nine years after PharmAthene filed suit), the Delaware Supreme Court focused on the award of expectation damages to the plaintiff in its review of the Court of Chancery's remand judgment. In affirming the remand order, the court reiterated the conventional view that a plaintiff must prove expectation damages with reasonable certainty, quoting from its *SIGA I* opinion that "no recovery can be had for loss of profits which are determined to be uncertain, contingent, conjectural, or speculative."[138]

However, the court also emphasized two presumptions to this rule. First, if an "injured party has proven the *fact* of damages—meaning that there would have been some profits from the contract—less certainty is required of the proof establishing the *amount* of damages."[139] Second, "doubts about the extent of damages are generally resolved against the breaching party."[140] A corollary of this "wrongdoer rule" is that the willfulness of a breach is relevant to a decision about the degree of certainty that is required.[141]

A dissent by Justice Valihura expressed two main concerns. First, the majority opinion recognized that Type II preliminary agreements (i.e., agreements in which some terms are open for negotiation) can be binding without the "concomitant limitations" that expectation damages must be proven with reasonable certainty.[142] In other words: "While I agree with the Majority's conclusion that the *fact* of damages must be proven with reasonable certainty, I disagree with its holding that the *amount* of damages does not have to be proven with reasonable certainty."[143] Second, the dissent concluded that the majority opinion is inconsistent with decisions in other leading commercial jurisdictions such as New York and California.[144] The majority responded that the dissent's discussion of these cases suggested that the "main dissatisfaction is with SIGA I and the rule it adopted permitting the recovery of expectation damages for bad

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136. PharmAthene, Inc., Quarterly Report, (Form 10-Q) (May 7, 2015), *available at* http://www.getfilings.com/sec-filings/150507/PHARMATHENE-INC_10-Q/ [hereinafter "PharmAthene Quarterly Report"].

137. *SIGA Technologies Receives NASDAQ Delisting Notification*, SIGA, (Mar. 18, 2015) http://investor.siga.com/releasedetail.cfm?ReleaseID=902359.

138. SIGA Techs., Inc. v. PharmAthene Inc. (*SIGA I*), 67 A.3d 330, 351 n.99 (Del. 2013).

139. SIGA Techs., Inc. v. PharmAthene Inc. (*SIGA II*), 132 A.3d 1108, 1150 (Del. 2015).

140. *Id.* at 1153.

141. *Id.* at 1111 (citing RESTATEMENT (SECOND) OF CONTRACTS § 352 cmt. A (1981)).

142. *Id.* at 1142.

143. *Id.* at 1150.

144. *Id.* at 1144–46.

faith breach of Type II agreements . . . . Whether it was correctly decided was not raised by the parties and is not before us in this appeal."[145]

A week before the *SIGA II* decision, PharmAthene and SIGA had reached an agreement that led to SIGA filing a Debtor's Plan under Chapter 11 of the Bankruptcy Code. Parts of the plan were contingent on the litigation's outcome and gave SIGA several options, including a cash payment in full or a transfer of all of its stock to PharmAthene.[146]

F. *Negotiation Lessons from SIGA II*

Given the defendant's huge liability based on expectation damages*, SIGA II* operates as a cautionary tale for negotiators in guiding their use of framework agreements. Here are some key factors they should consider when attempting to create or disclaim a duty to negotiate in good faith, or to avoid violating the duty to negotiate in good faith when opting to pursue a better alternative.

1. Lawyers and their clients should understand the liability risks that accompany good faith clauses in preliminary agreements, and that a change in their BATNAs might not justify a renegotiation of the deal.[147] To address this risk, they should consider stating in the agreements whether a change in their business prospects will modify their obligations.[148]
2. Parties who do not intend to be bound by a framework agreement should draft a clear invalidating clause that states, for example, "the parties are not bound until they sign a definitive agreement."[149] This is especially important when using a framework agreement that is fairly detailed, like the one in *SIGA II*.
3. Because actions subsequent to the execution of an invalidating clause might raise questions about the parties' intent to be bound, the clause should state that these actions do not create an intention to be bound.[150] But even this language might not provide protection

145. *Id*. at 1138.

146. Cara Salvatore, *SIGA Strikes PharmAthene Deal, Files Ch. 11 Plan*, LAW360 (Dec. 15, 2015), http://www.law360.com/articles/738239/siga-strikes-pharmathene-deal-files-ch-11-plan.

147. Robert M. Siegel & Stacia A. Wells, *Caveat Emptor: Non-Compliance with a Non-Binding Term Sheet Results in $195 Million Judgment*, LEXOLOGY (Mar. 7, 2016), http://www.lexology.com/library/detail.aspx?g=499facfe-8b09-4cad-86d2-f5df6b94b3e9.

148. James Baker & Mark Rosen, *Risky Business—Be Careful When Entering Into Term Sheets and Letters of Intent,* JD SUPRA (Feb. 9, 2016), http://www.lexology.com/library/detail.aspx?g=499facfe-8b09-4cad-86d2-f5df6b94b3e9.

149. *Id*.; *see* Stewart L. Mitchell, *Are You Afraid of Commitments? (If So, Be Careful Using "Non-Binding" Term Sheets*, STRASBURGER ATTORNEYS AT LAW, (Aug. 28, 2013), http://www.strasburger.com/afraid-commitments-careful-using-non-binding-term-sheets/.

150. Baker & Rosen, *supra* note 148 (citing Glenn D. West & Sarah E. Stasny, *Corporations*, 58 SMU L. REV., (2005)).

from a "good faith" claim where a party's communications refer to an agreement or breach thereof. As a result, "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."[151]

4. Negotiators should specify which jurisdiction governs their agreements, keeping in mind that they can bind themselves to a good faith duty in most common law jurisdictions.[152] If they intend to be bound by the duty to negotiate in good faith, the agreement should specify that it is governed by a state following the majority rule.[153] The agreements should also state a termination date for the duty.[154]
5. In certain states, a binding exclusivity clause might imply a duty to negotiate in good faith.[155] To avoid this implied duty, negotiators should select a governing state law that does not follow this approach. A preliminary agreement should also state clearly whether obligations are binding or not.[156] If terms in a preliminary agreement are binding, negotiators should determine the impact of those terms on securities regulation filings.[157]
6. In selecting the state governing law, negotiators should be aware that some states, like Delaware, allow expectation damages in certain circumstances.[158] As a result, they should consider selecting the law of a state that does not allow such damages.[159]
7. Negotiators can avoid the trap that was created in *SIGA II* by carefully reviewing "boilerplate language." In *SIGA II*, the "Non-Binding" LATS was trumped by other agreements that created an obligation to negotiate in good faith.[160] To avoid a similar mistake,

151. Robert Burwell & Howard Miller, *When a Non-binding Term Sheet Becomes Binding*, MINTZ LEVIN, (July 18, 2013), http://www.mintz.com/newsletter/2013/Advisories/3203-0713-NAT-COR/index.html.

152. Jeffries, *supra* note 72, at 15.

153. Among the states that refuse to enforce agreements to negotiate are Georgia, Hawaii, Kentucky, Michigan, Minnesota, Nebraska, Tennessee, Texas, Utah and Virginia. Warner, *supra* note 74.

154. David N. Shine & Aliza Herman, *Agreements to Agree: Breacher Beware*, LAW360, (Oct. 25, 2013), http://www.law360.com/articles/483057/agreements-to-agree-breacher-beware.

155. Warner, *supra* note 74.

156. Siegel & Wells, *supra* note 147.

157. Jordan Temple, *Is that Letter of Intent Enforceable?* JD SUPRA, (Mar. 8, 2016), http://www.jdsupra.com/legalnews/is-that-letter-of-intent-enforceable-11589/.

158. *See supra* note 125.

159. James Burgess & David Sands, *When is a Non-Binding Term Sheet or Letter of Intent Enforced as a Binding Contract*, CORP. & SECS. LAW BLOG (Sept. 13, 2013), http://www.corporatesecuritieslawblog.com/2013/09/when-is-a-non-binding-term-sheet-or-letter-of-intent-enforced-as-a-binding-contract/.

160. *See* Thaddeus J. Malik et al., *Delaware Supreme Court Rules that Expectation Damages are an Appropriate Remedy for Breach of an Obligation to Negotiate a Term Sheet in Good Faith*, PAUL

negotiators should conduct a careful review of term sheet "boilerplate language"[161] and similar language in all documents used in the transaction.

8. In situations where a duty to negotiate in good faith is created, caution should be exercised when proposing terms that differ substantially from the framework agreement. While, as Jeffries notes, genuine differences might prevent consummation of the deal,[162] the duty to negotiate in good faith might "bar a party from renouncing the deal, abandoning the negotiations, or insisting on conditions that do not conform to the preliminary agreement."[163]
9. In addition to appropriate selection of governing state law, negotiators should consider damage limitations, especially where there is a risk that courts will allow expectation damages. Limitations might be placed, for example, on lost profits and recovery of costs.[164] This might be accomplished through a liquidated damages provision.[165] Or damages might be limited to reliance damages.[166] But parties should understand that a mutual limitation cuts both ways and might be more harmful than beneficial if the other party refuses to negotiate in good faith.[167]
10. Depending on the complexity of the deal, negotiators should consider skipping the use of preliminary agreements entirely and moving directly to the final agreement, especially given the increased risks of using preliminary agreements after *SIGA II*.[168]

HASTINGS, (July 2013), http://www.paulhastings.com/docs/defaultsource/PDFs/delaware_supreme_court_rules_that_expectation_damages_are_an_appropriate_remedy_for_breach_of_an_obligation_to_negotiate_a_term_sheet_in_good_faith.pdf.

161. *Delaware Supreme Court Reaffirms That Express Agreement to Negotiate in Good Faith is Enforceable*, HOGAN LOVELLS, (July 12, 2013), http://ehoganlovells.com/cv/0fb419adc59492f9d96e407ba837488a85033e51.

162. Jeffries, *supra* note 72, at 17 n.88 (citing Teachers Ins. & Annuity Ass'n of Am. v. Tribune Co., 670 F. Supp. 491, 498 (S.D.N.Y. 1987)).

163. *Id.* at 16 n.76 (quoting John Klein & Carla Bachechi, *Precontractual Liability and the Duty of Good Faith Negotiations in International Transactions,* 17 HOUS. J. INT'L L. 1, 9–10 (1994)).

164. Burgess, *supra* note 159.

165. Kevin Smith, *Agreements to Negotiate in Good Faith May Mean More than You Think: Lessons Learned from the Preliminary Agreements in SIGA Technologies, Inc. v. PharmAthene, Inc.*, CHADBOURNE (Dec. 2013), http://www.chadbourne.com/AgreementstoNegotiateinGoodFaithMayMeanMoreThanYouThink_projectfinance/.

166. Abigail P. Bomba, et al., *A Change in Delaware in the Consequences of Willful Breach of an Obligation to Negotiate an Agreement in Good Faith—SIGA v. PharmAthene*, M&A BRIEFING (Jan. 19, 2016), http://www.friedfrank.com/siteFiles/Publications/FINALv4-1-19-2016-A%20Change%20in%20Delaware%20in%20the%20Consequences3.pdf.

167. Shine & Herman, *supra* note 154.

168. *Id.*

11. Communications can play an important role in determining liability. *SIGA II* illustrates that courts will consider internal communications (such as SIGA's communications indicating regret over entering into a preliminary agreement) and external communications (such as SIGA's communication to PharmAthene that there was "nothing to talk about" with regard to the terms of the original LATS).[169]
12. Subtle differences in wording might influence a court. If the intent is to create a non-binding agreement, in addition to labeling documents as "non-binding," negotiators should use tentative language—referring, for example, to the buyer as a "prospective buyer," and the transaction as a "potential transaction."[170]

CONCLUSION

The soundbite that has traditionally governed negotiation strategy is that civil law countries generally impose a duty to negotiate in good faith while common law countries do not. As a result, the BATNA strategies developed and advocated in a common law country like the United States may not be portable to civil law countries, where exercising the power represented by a strong BATNA can violate the duty to negotiate in good faith.

However, as shown in this article, there is an exception to the U.S. approach in that parties can enter into an agreement to negotiate in good faith. In a world of complex commercial deals, even sophisticated negotiators can unknowingly agree to a duty to negotiate in good faith, as *SIGA II* illustrates. And the expectation damages arising from a breach of the good faith duty, as *SIGA II* shows, can be much more severe than the typical reliance damages awarded in civil law countries.

Negotiators are justified in thinking that a duty to negotiate in good faith is problematic because it restricts their use of power-oriented BATNA strategies. If this is a concern, they should consider the lessons from *SIGA II* listed in Part II. However, negotiators should also determine whether the good faith duty provides two types of benefits. First, the duty might encourage them to adopt a positive, interest-based negotiating approach that creates an opportunity to benefit both sides.

The second, and less obvious, benefit is that adopting a positive approach might mitigate potential liability. For example, if the defendant in *SIGA II* had framed its proposals as an opportunity to create economic value for both sides, and attempted to show that the plaintiff could also benefit financially as a result, the court might have looked more favorably at these proposals. As the court noted, bad faith "implies the conscious doing of a wrong because of dishonest

169. *Id.*
170. Temple, *supra* note 157.

purpose or moral obliquity . . . it contemplates a state of mind affirmatively operating with furtive design or ill will."[171] Under this definition, a positive, value-creating approach might enable a defendant to prove good faith.

SIGA II provides a cautionary tale of what can happen when negotiators select a value-claiming BATNA-based strategy when unknowingly entering into an agreement to negotiate in good faith. When negotiations between the parties began in late 2005, the defendant faced financial problems and needed around \$16 million to develop its drug. In other words, defendant had a weak BATNA. By October 4, 2006, however, defendant's alternatives were much stronger after it obtained a \$16.5 million grant and achieved great success in a trial of its drug. Emboldened by its new-found power that resulted from its strengthened BATNA, defendant attempted to change the basic terms of the negotiation to its own benefit, and by the end of the year issued an ultimatum to plaintiff that unless the negotiations proceeded "without preconditions" the parties had "nothing more to talk about."[172]

In other words, instead of adopting a positive, value-creating negotiation strategy that emphasized a focus on interests and options for mutual gains, the defendant opted for a value-claiming power strategy after its BATNA became stronger.[173] What were the consequences of this power strategy? When the negotiations started in late 2005, both parties conservatively estimated the value of the smallpox drug at around \$1 billion. During merger negotiations the following year, it was "looking more and more like a multi-billion dollar drug."[174] Had the parties adopted a mutual gains strategy based on the terms in the original LATS or even the 50-50 profit split that defendant later proposed and plaintiff was "willing to consider,"[175] the pie might have grown even larger, benefitting both sides.

Instead, in exercising its BATNA-fueled strategy, defendant failed to negotiate in good faith, which resulted in litigation that led to defendant's bankruptcy filing. Plaintiff also suffered financially in sustaining the case, having to eliminate two-thirds of its workforce to preserve enough cash to operate through the appeal. Calculations based on the Chancery Court's order on January 15, 2015 indicate that plaintiff's attorney fees had reached close to \$6 million by that date,[176] and undoubtedly continued to rise during the appeals

171. SIGA Techs., Inc. v. PharmAthene Inc. (*SIGA I*) 67 A.3d 330, 346 n.66 (Del. 2013) (citing CNL-AB LLC v. E. Prop. Fund I SPE (MS REF) LLC, 2011 WL 353529, at *9 (Del. Ch. Jan. 28, 2011), and quoting Desert Equities, Inc. v. Morgan Stanley Lev. Equity Fund, II, L.P., 624 A.2d 1199, 1208 n.16 (Del. 1993)).

172. *SIGA I*, 67 A.3d at 341.

173. See supra notes 100–102 and accompanying text.

174. *SIGA I*, A.3d at 347.

175. *Id.* at 340.

176. PharmAthene, Inc. v. SIGA Techs., Inc., No. 2627-VCP (Del. Ch. 2014) (final order and judgment), *available at* http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=5&ved=0CDcQFjAE&url=http

process. If defendant's fees are similar, the parties expended well over $12 million in attorney fees alone while fighting over a shrinking pie. This expense does not include other direct litigation costs and expenses; nor does it include the opportunity costs associated with management time. These opportunity costs, while often overlooked by litigants, can be substantial; for example, "for a company in the $100 million to $200 million range the disruption factor of a typical patent infringement case amounts to the loss of about six to eight months of new product development."[177]

In summary, in a global economy, negotiators must understand differences between the legal framework for negotiations in civil law and common law countries. In civil law systems, the duty to negotiate in good faith is the default position unless parties opt out, while in common law systems there is generally no duty to negotiate in good faith unless parties opt in through an agreement creating the duty. In making decisions whether to opt in or opt out, negotiators should keep in mind that apart from practical considerations described in this article, a good faith negotiation might yield positive results by encouraging interest-based, value creation results.

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