COURT OF CHANCERY
OF THE
STATE OF DELAWARE

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VICE CHANCELLOR

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Re: *PharmAthene, Inc. v. SIGA Technologies, Inc.*,
Civil Action No. 2627-VCP

Dear Counsel:

The Final Order and Judgment (the "Judgment") implementing the Court's rulings in its post-trial Opinion dated September 22, 2011 (the "Opinion") is being entered concurrently with this Letter Opinion. In January 2012, each party submitted a proposed form of final order implementing the equitable remedy provided for in the Opinion. From those competing forms of final orders and the parties' submissions to the Court thereafter, no less than thirty discrete points of disagreement are apparent. This Letter Opinion indicates briefly the Court's resolution of each of those disputed issues.

Preliminarily, I note that, to the extent the parties' respective proposed orders reflect mutual agreement on a particular term or the desirability of including terms not expressly required by the Opinion, I have attempted to respect the parties' agreement. As to any issue raised by one party but to which the other party did not respond, I have treated the lack of response as indicative of acceptance of the opposing party's position. Regarding the issues that are in dispute, I have included the following terms in the accompanying Judgment, relying on the reasoning set forth in the Opinion in each instance.[1]

1. Calculation of the First $40 Million Setoff. The Judgment incorporates PharmAthene's proposed language as consistent with the plain language of the Opinion.[2]

2. Product Expenses Incurred Before the Date of the Judgment. The Court accepts SIGA's contention that Total Product Expenses[3] should include all product-related expenses, whenever incurred. The Opinion granted PharmAthene an "equitable

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[1] For ease of reference, I address the disputed matters in the order in which they were raised in SIGA's letter to the Court dated January 13, 2012. *See* Docket Item ("D.I.") No. 312 (Jan. 13, 2012). All docket items cited in this letter refer to the docket in this action, C.A. No. 2627-VCP.

[2] *PharmAthene, Inc. v. SIGA Techs., Inc.*, 2011 WL 4390726, at *42 (Del. Ch. Sept. 22, 2011) [hereinafter Opinion] ("once SIGA earns $40 million in net profits or margin from net sales of ST–246, PharmAthene shall be entitled to 50% of all net profits from such sales thereafter").

[3] Capitalized terms not otherwise defined in this Letter Opinion have the meanings ascribed to them in the Judgment and the Opinion.

payment stream" on "net profits," which implies that actual costs and expenses should be deducted.

3. Treatment of Research & Development Expense. The Judgment includes SIGA's definition of Research & Development (R&D) Expense within the definition of Total Product Expenses for the same reason stated in Paragraph (2), *viz.*, that the term "net profits" connotes accounting for all costs and expenses necessary to realize those profits. To the extent PharmAthene fears that SIGA will attempt to deduct R&D expenses funded by the U.S. government or some other third party, Paragraph 2(d)(3)(a) of the Judgment addresses that concern.

4. Worldwide or Territory-by-Territory Approach. The Judgment adopts a worldwide, ten-year term following the First Commercial Sale for the reasons explicitly indicated in the Opinion.[4]

5. Other Limitations on Expenses.

a. *Direct Relationship between R&D Expense and Timing of Product Delivery*. The Court accepts SIGA's definition of R&D Expense as consistent with

[4] *Id.* at *41 ("Because neither party presented evidence regarding specific patents relating to ST–246 or the countries in which such patent coverage exists, I will limit the equitable lien on sales of ST–246 to a term of ten years from ST–246's, or a closely related product's, first commercial sale. Any attempt to expand the term to encompass countries and sales for which patent coverage does not expire until after ten years from the first commercial sale would force this Court into an unacceptably onerous enforcement or supervisory role.").

industry practice, as required by the Opinion. In doing so, the Court agrees with SIGA that PharmAthene's proposal to limit R&D Expense deductions to those "directly related" to Product delivered during the Payment Period would be vague and unduly burdensome to enforce. As to PharmAthene's professed concerns that SIGA will manipulate the accounting of such expenses, PharmAthene's interests are protected by several provisions of the Judgment, including the "outside-funding" clause of Paragraph 2(d)(3), the allocation clause of Paragraph 2(d)(5), and SIGA's obligation under Paragraph 2(g) to act in good faith.

b. *Treatment of "Allocable Overhead."* The Court accepts SIGA's definition of SG&A Expense as more likely to account for all expenses incurred to realize net profits.

c. *Allocation of Common Costs*. Paragraph 2(d)(5) of the Judgment incorporates SIGA's method of allocating common costs, but with slightly different language, as more reasonable than that proposed by PharmAthene.

d. *Treatment of "Costs of Sales."* The Court accepts SIGA's definition of SG&A Expense as more likely to account for all expenses incurred to realize net profits.

e. *Treatment of Noncash Compensation*. SIGA has not controverted Edwards's expert opinion that noncash compensation typically is excluded as a deductible expense for purposes of biopharmaceutical patent licensing transactions.

Rather, SIGA argues only that such an exclusion departs from U.S. GAAP. In the context of the relief granted in the Opinion and the potential for manipulating noncash compensation expense here, I find SIGA's position unpersuasive. Accordingly, Paragraph 2(d)(3)(b) of the Judgment preserves the exclusion of noncash compensation from the calculation of Total Product Expenses.

f. *Treatment of "Marketing Costs."* The Court accepts SIGA's definition of R&D Expense, which incorporates PharmAthene's proposed "Marketing Costs" and certain additional items, as better accounting for all expenses incurred to realize net profits. Any legitimate fears PharmAthene may have that SIGA will deduct expenses attributable to SIGA's business generally should be assuaged by the allocation clause of Paragraph 2(d)(5).

6. Timing of Sales. The Judgment adopts PharmAthene's definition of First Commercial Sale, which requires both delivery of Product and receipt of payment. That definition is in accord with industry practice. It also serves the important purposes of (i) defining clearly the events that commence the Payment Period and (ii) doing so in a manner that should eliminate any doubt as to the bona fides of the transaction. As to all other sales after the First Commercial Sale, the Judgment accepts SIGA's definition predicated on U.S. GAAP-based principles for recognition of revenue. The Court takes seriously, however, PharmAthene's concerns that SIGA might structure such sales with terms that serve to delay recognition of revenue and thereby evade the "equitable

payment stream" ordered. Accordingly, to buttress the protections afforded PharmAthene by Paragraph 2(g), the Court has supplemented SIGA's proposed definition of Net Sales to align with recognition of revenue under U.S. GAAP by providing that it applies only so long as,

> SIGA employs accrual method accounting under GAAP in good faith and does not structure the terms of Commercial Sales for the purpose of delaying recognition of revenue under GAAP or otherwise avoiding the spirit of its obligations under the "equitable payment stream" ordered in this Final Order and Judgment.

7. The Audit Procedure. The competing proposals reflect a number of disagreements with respect to the audit procedure to be provided for in the Judgment. Accordingly, the Court has imposed the particular terms of the audit procedure based on the Opinion, the areas of sufficient agreement between the parties, and industry custom. As to the competing proposals' related dispute resolution mechanisms (*e.g.*, a prescribed interest rate on any underpayments), however, most of the parties' disagreements do not relate to matters at issue in the litigation or addressed in the Opinion. As such, the Opinion provides no basis for accepting or rejecting specific aspects of such mechanisms that a party may deem desirable. Therefore, the Court has omitted both parties' proposed last sentence to Paragraph 2(b), and Paragraph 2(c) of the Judgment is only as detailed as the Court considers warranted based on practical concerns and certain areas where the competing proposals of the parties reflected near agreement. To the extent the parties

consider it advisable to agree to additional or modified procedures, they remain free to do so without the Court's substantive involvement.

8. Definition of Product. The Judgment incorporates PharmAthene's proposed definition of Product, except that the Court replaced prong (iv) of that definition with the following language from the LATS: "any other orthopox related small molecule therapeutic product derived from the same family of tricyclononenes that ST-246 was derived from."[5]

9. Treatment of Combination Products. Combination products were not addressed in the Opinion. Indeed, the proper treatment of them was never raised until SIGA's letter of January 13, 2012, after which the parties failed to agree on a mutually acceptable approach. Accordingly, the Judgment omits any reference to combination products. As with the audit procedures, the parties remain free to make separate provision for the treatment of combination products without the Court's involvement.

10. Additional Disputes Identified in SIGA's January 13, 2012 Letter.

a. *Timing of Reports & Payments*. Paragraph 2(c) of the Judgment requires SIGA to send quarterly reports and payments to PharmAthene within sixty days of the end of each calendar quarter.

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[5] JTX 11 at 1.

b. *Treatment of Disposition Transactions*. The Opinion expressly required

> the parties [to] include in the definition of "net sales," or elsewhere in the proposed judgment, proceeds from any dispositions of the intellectual property rights to ST–246 within the specified term (*e.g.*, should SIGA license, assign, or otherwise transfer any such rights to ST–246 to a third party). To the extent the parties cannot agree, the Court will impose the required terms in accordance with industry practice.[6]

Neither party's proposed treatment of such transactions was satisfactory to the Court.

PharmAthene's proposed definition arguably would entitle it to receive half of all proceeds from any transaction in which SIGA's rights in ST-246 were disposed of, regardless of whether that transaction involved additional elements of exchange. For example, if SIGA agreed to sell all or substantially all of its assets, PharmAthene's proposed definition would entitle it to half of all these sale proceeds. Additionally, PharmAthene's proposed definition apparently would entitle it to receive otherwise ordinary Net Profits beyond the end of the ten-year "equitable payment stream." By including "licenses" within its definition of a disposition transaction and providing that PharmAthene would receive one half of "all proceeds . . . paid or to be paid (*whenever that shall occur*) as a result of the Disposition Transaction,"[7] PharmAthene could claim

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[6] Opinion, 2011 WL 4390726, at *42 n.250.

[7] D.I. No. 308, at 5 (Jan. 10, 2012).

the right to receive running royalty payments on sales made after the expiration of the "equitable payment stream."

I also consider SIGA's proposed treatment of disposition transactions to be problematic. SIGA incorporated disposition transactions within its definition of Net Sales, which are defined by the recognition of revenue under U.S. GAAP. SIGA's approach, therefore, would exclude all proceeds from extraordinary transactions.[8] Thus, for example, SIGA's proposed treatment would capture running royalty payments under a license agreement, but not a sale or assignment of the patent itself.

The Court, therefore, has provided its own treatment of disposition transactions in Paragraph 2(e) of the Judgment. That Paragraph, together with the Court's definitions of Disposition Transaction and Disposition Transaction Proceeds, provides that (1) running royalty payments from licenses of Product-related intellectual property shall be treated as Net Sales, and PharmAthene shall have no entitlement to share in such revenues after the Payment Period expires, but (2) PharmAthene shall be entitled to share in the proceeds of any other extraordinary disposition of Product (to the extent such proceeds are reasonably

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[8] *See* Financial Accounting Standards Board, Statement of Financial Accounting Concepts No. 6, ¶¶ 78-79, 82, 84-88 (2008) (defining revenues as "inflows or other enhancements of assets . . . from . . . *activities that constitute the entity's ongoing major or central operations*" and in contrast to gains, which, though similar to revenues, "result from incidental or peripheral transactions" (emphasis added)), *available at* http://www.fasb.org (follow "Standards, Concept Statements" hyperlink; then follow "Concepts Statement No. 6 [As Amended]" hyperlink).

allocable to Product, as opposed to other elements of exchange) that occurs before or during the Payment Period, even if the payment to SIGA of such proceeds occurs after the Payment Period expires.

c. *Treatment of Foreign Currency Transactions*. SIGA proposed the inclusion of an express provision for the treatment of foreign currency transactions. PharmAthene did not object to that concept or the proposed language. Accordingly, I have included such a provision in the Judgment, but I modified SIGA's language slightly so that the provision applies equally to the Court's newly-added definition of Disposition Transaction Proceeds.

d. *Timing of SIGA's Obligation to Pay Attorneys' Fees*. Although they have suggested different due dates, both PharmAthene and SIGA proposed a date certain for SIGA to make payment to PharmAthene for whatever attorneys' fees, expenses, and costs are awarded. Consistent with this Court's usual practice, however, the Judgment does not prescribe a specific due date for the payment of those sums. Instead, all sums awarded pursuant to Paragraph 3 of the Judgment shall accrue post-Judgment interest at the legal rate, currently 5.75% (and subject to change with any changes to the Federal Reserve Discount Rate), until SIGA makes the requisite payment. In this regard, the Court inserted a new Paragraph 5 directing the Prothonotary of the Superior Court to enter the Judgment to the extent it calls for the payment of a sum of money, in accordance with 10 *Del. C.* § 4734.

e. *Treatment of BARDA Line Item Number 13*. Based on the record before me, it appears that any money due to or received by SIGA under line item number 13 of SIGA's BARDA contract would reflect reimbursement of an expense rather than sales proceeds. Accordingly, the Judgment excludes any such money from the definition of Net Sales.

11. Additional Disputed Issues Regarding the Equitable Payment Stream.[9]

a. *Patent Enforcement Suits*. The Judgment provides for the treatment of (1) Patent Preparation Fees as a deduction from Total Product Expenses and (2) "all amounts recovered as a result of Product-related patent or trademark infringement suits, claims or actions or settlements thereof" as a component of Net Profits. The Court explicitly included such recovery amounts within the definition of Net Profits to avoid any confusion regarding whether they would qualify as recognized revenue under GAAP.[10]

b. *Treatment of Government-Funded Drug Trial Expenses*. While the definition of R&D Expense includes "government-funded trial expenses of $10.2 million," Paragraph 2(d)(3)(a) states explicitly that Total Product Expenses shall not include as a cost "any item paid for, funded or reimbursed, whether directly or indirectly,

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[9] The following issues were raised for the first time in PharmAthene's letter to the Court dated January 26, 2012. D.I. No. 315, at 15-16 (Jan. 26, 2012).

[10] *See* note 8, *supra*.

by the U.S. or a foreign government or any other customer or Third Party." To avoid any potential conflict between these provisions, the Court has added an express clause subordinating the definition of R&D Expense to Paragraph 2(d)(3)(a).

c. *References to Constructive Trust and Equitable Lien*. The Court replaced all references to a "constructive trust and equitable lien" in segments drawn from PharmAthene's proposal with "an equitable remedy in the form of an 'equitable payment stream.'" This revision comports with both the Opinion[11] and the later Memorandum Opinion denying SIGA's motion for reargument.[12]

d. *Singular or Plural Form of "Deduction."* Paragraph 2(b) employs the plural word "deductions," consistent with the corresponding language from the Opinion.[13]

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[11] *E.g.*, Opinion, 2011 WL 4390726, at *38 (Relief "in the form of an equitable payment stream *akin* to a constructive trust or an equitable lien on a share of the proceeds from ST–246 deserves serious consideration." (emphasis added)).

[12] *PharmAthene, Inc. v. SIGA Techs., Inc.*, 2011 WL 6392906, at *3 (Del. Ch. Dec. 16, 2011) ("this Court enjoys remedial flexibility to depart from strict application of the ordinary forms of relief where circumstances require" and "the Court found the underlying purposes of a constructive trust and equitable lien applicable to the circumstances of this case and endeavored to tailor those remedies . . . in the form of an equitable payment stream").

[13] Opinion, 2011 WL 4390726, at *42 ("SIGA shall be required to keep records . . . showing any *deductions* from such sales or dispositions in deriving 'net sales'" (emphasis added)).

e. *Other Obligations*. Paragraph 2(g) clarifies that the terms of the Judgment "apply to SIGA's heirs, assigns and successors-in-interest." In all other respects, it sufficiently reflects SIGA's continuing obligation to act in good faith.

f. *Continuing Jurisdiction of the Court*. The Judgment omits any reference to the Court's continuing jurisdiction, except to the extent that it provides for the Prothonotary to enter the Judgment in accordance with 10 *Del. C.* § 4734.

12. Amount of Attorneys' Fees Awarded.

a. *Pre-Filing Fees*. In response to SIGA's initial objection, PharmAthene conditionally waived its request to recover a portion of the $33,341.79 in attorneys' fees it incurred before the Complaint was filed on December 20, 2006. The condition was that no hearing be held on this issue.[14] Because no hearing was held regarding the form of Judgment, the condition was satisfied and such attorneys' fees are excluded.

b. *Post-Opinion Fees*. Over SIGA's objection, the Court has included 100% of PharmAthene's post-Opinion fees in the Judgment. All of these fees relate exclusively to claims on which PharmAthene prevailed at trial and "in [some] way relate

[14] PharmAthene's Resp. to SIGA's Opp'n to Certain Costs & Att'ys' Fees, D.I. No. 315, ¶ 9 (Jan. 26, 2012).

to the inaccuracy, breach of or default under any representations, warranties or covenants" under the Bridge Loan Agreement.[15]

c. *McGuire Woods Fees.* As SIGA noted in its submissions, the record does not disclose the involvement of any attorney associated with McGuire Woods in the provision of legal advice or services to PharmAthene in connection with this litigation, and PharmAthene provided no documentation substantiating any fees it incurred from McGuire Woods. Furthermore, the Court declines PharmAthene's invitation to inspect *in camera* more detailed billing records because any further delay in the entry of Judgment here would be untenable. Because PharmAthene failed to carry its burden to show that McGuire Woods performed reimbursable services for it in connection with this litigation, the Court concludes that an award of any attorneys' fees for such services would be unreasonable. Therefore, the Judgment does not award any fees for work by McGuire Woods.

13. Costs Awarded Under Rule 54(d).

a. *Expenses*. The term "'costs' for purposes of Rule 54(d) ha[s] been deemed to include 'expert witness fees that are covered by statute, court filing fees, and the usual and customary costs incurred in serving of process,' but not 'the expense of computer legal research, transcript fees, miscellaneous expenses (such as travel and

[15] JTX 36 § 7.6.

meals), and the cost of photocopying.'"[16] Thus, as a general matter, SIGA is correct that the customary expenses incurred by PharmAthene's legal professionals ordinarily are not "costs" under Rule 54(d).

Nevertheless, the Opinion awarded PharmAthene its attorneys' fees and expenses under Section 7.6 of the Bridge Loan Agreement,[17] in which the parties agreed to indemnify one another for all "expenses of whatever kind or nature . . . including, without limitation, counsel and consultant fees *and expenses* . . . in any way related to the inaccuracy, breach of or default under any representations, warranties or covenants" made in that Agreement.[18] Thus, subject to the one-third limitation imposed by the Court, PharmAthene has a right to both attorneys' fees and expenses. PharmAthene's misuse of nomenclature notwithstanding, the Judgment provides for SIGA to pay (a) one-third of PharmAthene's attorneys' fees and expenses, collectively, up to the date of the Opinion and (b) 100% of PharmAthene's attorneys' fees and expenses, collectively, through the date of the Judgment. Consistent with Paragraph 12(a) of this Letter

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16 *Jackson's Ridge Homeowners Ass'n v. May*, 2008 WL 241617, at *1 n.3 (Del. Ch. Jan. 23, 2008) (quoting *Dewey Beach Lions Club v. Longacre*, 2006 WL 2987052, at *1 (Del. Ch. Oct. 11, 2006)).

17 Opinion, 2011 WL 4390726, at *44 ("Based on the plain meanings of SIGA's obligations under . . . the Bridge Loan Agreement . . . I also conclude that PharmAthene is entitled to recover its attorneys' fees *and expenses* in this action related to SIGA's breach." (emphasis added)).

18 JTX 36 § 7.6 (emphasis added).

Opinion, however, all expenses incurred before December 20, 2006 are excluded from the amount awarded.

b. *TrialGraphix Fees.* PharmAthene has not identified, nor is the Court aware of, any precedents holding that expenses paid to trial consulting firms fall within the narrow scope of "costs" under Rule 54(d). Therefore, the Court declines to treat the expenses PharmAthene incurred in connection with its retention of TrialGraphix as taxable "costs" under that Rule. Nevertheless, as just discussed, Section 7.6 of the Bridge Loan Agreement entitles PharmAthene to recover, among other things, "consultant fees and expenses." Hence, the Judgment accounts for the contested TrialGraphix fees and expenses as a component of the broader amount of attorneys' fees and expenses awarded to PharmAthene. Because PharmAthene incurred these costs before the date of the Opinion, however, only one-third of the total amount invoiced is recoverable.

c. *Other "Costs."* PharmAthene identified only three categories of "costs" for purposes of Rule 54(d): those paid to (1) its experts, (2) its attorneys, and (3) TrialGraphix. There is no dispute as to the amount of experts' fees that PharmAthene may recover. Moreover, as discussed above, the Court has based any award for amounts paid to attorneys and TrialGraphix on PharmAthene's contractual entitlement to such amounts, not on Rule 54. Because PharmAthene did not submit evidence of any other amounts, the Court assumes that all the costs PharmAthene could have recovered under Rule 54(d) are included within those three general categories. In any case, the Court

lacks an evidentiary basis to award any other costs typically taxed under Rule 54(d) and, therefore, makes no further provision for costs in the Judgment.

The Final Order and Judgment reflecting the rulings in this Letter Opinion, the Opinion, and the Memorandum Opinion is being entered concurrently herewith.

Sincerely,

/s/ Donald F. Parsons, Jr.

Donald F. Parsons, Jr.
Vice Chancellor