
VALUE PHARMING NEGOTIATION

General and Confidential Information for Pure Health Attorney

General Information

Next-Pharm began as a joint venture between the State University Bio-Medical Research Department and Pharmalux, then a small young but promising pharmaceutical company.¹

Next-Pharm's advisory board included representatives of Pharmalux and the University and of the city and state's business development offices. Next-Pharm drew upon considerable time and expertise of State University's bio-medical graduate students and professors for research design, with joint responsibility for research implementation and product development. Next-Pharm owned the intellectual property created. Proceeds from the sale or licensing of the intellectual property are distributed back to State University and Pharmalux, after funds needed for ongoing or planned research projects are set aside. Drug and drug delivery systems developed and designed are produced, marketed, and sold exclusively by Pharmalux. The licensing fees paid by Pharmalux are kept reasonably low in consideration for its technical assistance to and cooperation in the Next-Pharm joint venture. If and when Pharmalux decides to discontinue production of a Next-Pharm patented technology, the rights to license or sell the technology revert back to Next-Pharm. At that point, Next-Pharm has the right to license or sell the technology to an outside company.

Everyone agrees that the Next-Pharm joint venture has worked magnificently. It is a model of the synergies possible between academic University based science and medical research and private industry.

Over the last five years, Next-Pharm patented two similar products, Immuno-Plus and ImmunoPure, and licensed them to Pharmalux for manufacturing and sale. Both drugs are designed to boost the immune system in immune deficient patients. Immuno-Pure uses an extremely pure and costly manufacturing process and is necessarily priced high. Shortly after Immuno-Pure had been licensed and was in production at Pharmalux, Next-Pharm developed Immuno-Plus, which

¹ By way of background: ten years ago, the State's Business Development office had provided initial "incubator" services for Pharmalux through its small business incubator initiative, and the city provided property tax breaks when Pharmalux agreed to locate in an "urban development area." Five years later - five years ago - Pharmalux had proven itself to be successful with a suite of modestly profitable products aimed a range of food allergies. The Pharmalux CEO and C-Suite had earned the respect of city and state officials and enjoyed good relationships within the area's medical/pharmaceutical research community. Thus, Pharmalux was an obvious choice when the State University's Medical Research Department sought a joint venture partner for further R&D, manufacturing, and marketing of a new set of drugs and drug delivery systems.



uses a far less expensive manufacturing process. Pharmalux eagerly began producing and marketing Immuno-Plus, for it could be priced lower and still yield much higher profit margins.

Most patients tolerate both drugs well. However, a minority of patients develop debilitating headaches and nausea from the less expensive Immuno-Plus. Most insurers will only pay for Immuno-Plus, absent physician verification of a patient's serious adverse reaction to it. Both drugs currently require intravenous delivery to patients.

Three months ago, Pharmalux decided to discontinue manufacture of Immuno-Pure, and to expand production of the lower cost, more profitable Immuno-Plus. The Pharmalux marketing team announced that production of Immuno-Pure would cease within the next few months, so that customers could stock up. There is no other source of Immuno-Pure.

Shortly thereafter, a small group of Pharmalux scientists announced their desire to leave Pharmalux to launch their own company, Pure Health, committed to producing Immuno-Pure. This Pure Health group obtained a tentative "green light" from Pharmalux, which agreed that production and selling of Immuno-Pure would not violate their non-compete agreements. The precise scope of the release of their non-competes had not been worked out. However, reassured that they would at least be able to manufacture and sell Immuno-Pure, the Pure Health team approached Next-Pharm to determine the cost of licensing or purchasing the rights to the Immuno-Pure technology.

Both the Pure Health team and the Next-Pharm board decided it would be best for their lawyers to represent them in the negotiation. (The Next-Pharm president is more of a scientist than a negotiator; the Pharmalux board representatives would have a pretty clear conflict of interest. It could also be argued that the University representative is also conflicted as most of the Pure Health team are university professors or researchers.) It is understood that lawyers would have to obtain approval from their client for any deal terms other than those specifically authorized. In any event, Next-Pharm's lawyer is authorized to make only a tentative deal, which would have to be approved by its board.

The two lawyers are about to meet to negotiate.

Confidential Information for Pure Health's Attorney

You are a lawyer in a mid-sized and highly respected downtown law firm. Your practice is in commercial transactions, and you have a great deal of experience working with intellectual property issues that arise in that context. One of the firm's partners has been working with the Pure Health team to set up its corporate structure and the terms of its financing. He referred this matter to you for your negotiation and IP experience. The referral was an easy one. You are friendly with one of the prospective Pure Health scientists whose daughter is in your kids' preschool.

When you met with the Pure Health client team to prepare for the negotiation, they explained that the original idea to form Pure Health came from an Immuno-Pure patient, a mother with a genetic immune deficiency, inherited by her son. When she learned of Pharmalux's plan to discontinue Immuno-Pure, she contacted Pharmalux managers to plead: "Don't just abandon us and Immuno-Pure. Give the patents to us. We'll get it made." The woman's plea was compelling to you and to the chief Immuno-Pure scientist and his top associate, a production engineer, and a product manager.



The team met as a group several times, decided on the “Pure Health” name, and hatched a business plan. Their chief scientist completed an MBA with his PhD from MIT and has terrific contacts in the financial world. Others might see Pure Health as “rag tag” or unsophisticated, but (with your law firm’s help), they have lined up business assistance and financing from a specialized venture capitalist firm with a rare appreciation for Immuno-Pure technology and its potential applications.

You (and your clients) were delighted at Pharmalux’s expressed willingness to release the Pure Health group from their standard two-year non-competes at least for the purposes of producing Immuno-Pure. With that hurdle passed, they met with the venture capitalists to discuss what Pure Health could afford to pay for Immuno-Pure. Neither you nor your clients know whether Next-Pharm will prefer to sell or to license the Immuno-Pure technology, so you prepared for either scenario.

Pure Health strongly prefers to purchase the Immuno-Pure patents outright, rather than operate through licensing or royalty arrangements. The venture capitalists have asserted their belief that royalties and license fees are too expensive in the long run. With a straight purchase, Pure Health will clearly own any improvements to the technology, without legal entanglements.

Perhaps most important, your client’s chief scientist is certain that the Immuno-Pure technology could be used to develop an entirely new product line of anti-microbial coatings for industrial and medical equipment because Pharmalux is not in that business at all. This would involve use of the Immuno-Pure patents but would not violate any of the Pure Health group’s non-compete agreements. This is top secret and makes the Immuno-Pure patents extremely valuable to Pure Health. Even if the anti-microbial product does not work out, the group believes Immuno-Pure technology could be used for other future products.

Despite its enormous potential value, there is a limit on what Pure Health can pay for the rights to Immuno-Pure technology. Based upon the venture capitalists’ calculations, that limit is \$8 million. Any more than \$8 million will cause the venture capitalists to pull financing or demand controlling ownership – neither is acceptable. The group has projected that Immuno-Pure could generate as much as \$20 million in gross revenues per year, with a 20% or \$4 million profit margin per year (before paying for Immuno-Pure technology rights), using current manufacturing methods. Your chief scientist is confident that he could improve the manufacturing process resulting in cost savings.

You have no idea what Next-Pharm will demand for the Immuno-Pure rights. You clients suspect the original R&D costs for Immuno-Pure and Immuno-Plus were \$5-6 million, based upon the scientific work done and their experience. They don’t know how much Next-Pharm has recouped to date, or whether that matters. Obviously, the less you pay the better for Pure Health.

If Next-Pharm is unwilling to sell the Immuno-Pure patents outright, Pure Health would go forward with a licensing fee arrangement, as long as they were not prohibited from using the technology for other products. While they would prefer no limitation on “other products” they would be willing refrain from products competitive with Pharmalux’s currently marketed products. The venture capitalists have set a limit of no more than \$1.6 million per year in licensing fees, which would represent 40% of projected profits from Immuno-Pure. While NextPharm may suggest a royalty structure based upon gross sales, the Pure Health will resist this. They do not want to report annual sales numbers to Next-Pharm, which is partially owned by Pharmalux.

Your clients are eager to get going. Pure Health has to find space and start up. That will cost money and take time. Delay is more costly than an extra dollar or two for Immuno-Pure technology.

If no agreement is reached, the Pure Health principals have indicated that they will theoretically continue at their Pharmalux jobs. Of course, they would all be concerned about repercussions. Based on your experience, those concerns are legitimate. Once it is known that a Pharmalux employee was ready to leave with a new venture, that employee may no longer be regarded as a loyal member of the Pharmalux team.