
VALUE PHARMING NEGOTIATION

General and Confidential Information for Next-Pharm Attorney

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 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.

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.

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 Next-Pharm Attorney

You are a lawyer at a mid-sized and well-respected law firm. You joined the law firm after ten years in the law department of D&T, an international consumer products company, where you gained experience in IP as well as general commercial and real estate transaction. Prior to your work at D&T, you had worked in the City Solicitor's office, covering the public health department and economic development initiatives.

Next-Pharm recently retained you to represent the joint venture's interests in negotiations with the group of Pharmalux scientists seeking to leave to continue to produce and sell Immuno-Pure. (It turns out that Next-Pharm's President had a PhD scientist friend in D&T's research division, who had known you from D&T's law department.)

The original negotiations to form Next-Pharm were conducted by representatives of both sides of the joint venture – the for-profit Pharmalux company and the University, with input from representatives of city and state entities with a stake in Next-Pharm's success. These players then came to sit on the Next-Pharm board.

For the upcoming negotiations, it was recognized Next-Pharm required separate representation. However, it's also true that Next-Pharm will continue to exist only if its joint venture partners are

both satisfied. And this deal to spin-off Immuno-Pure will be approved only if it meets the interests of the board members and thus the stakeholder entities.

Next-Pharm's President confirmed to you that, since Pharmalux announced its planned discontinuance of Immuno-Pure, Next-Pharm has received countless entreaties from ImmunoPure patients to pressure Pharmalux to reconsider the decision. These patients will suffer painful and debilitating reactions to the other drug. The State University scientists involved with Next-Pharm have expressed anger at the notion that their Immuno-Pure technology would be taken from these patients. Fortunately, Pharmalux honored the contractual provision for reversion of Immuno-Pure technology rights back to Next-Pharm.

Thus, the Next-Pharm President and its board members were delighted to learn that some insiders at Pharmalux had expressed a desire to form Pure Health to take up the production and sale of Immuno-Pure. While Next-Pharm could theoretically sell its Immuno-Pure technology to another company, whose principals were not former Pharmalux employees, finding such a company might be difficult and production of Immuno-Pure would inevitably be delayed.

From the perspective of the State's and the City's board representatives - State's- really the public perspective - it would not be right to provide start-up assistance to foster a joint venture between State University scientists and a pharmaceutical company and then take the venture's product away from patients who need it.

For that reason, a number of Next-Pharm board members successfully urged Pharmalux to release the Pure Health group from their non-compete agreements so that they could produce Immuno-Pure. You assume that they have located some financing, but you know nothing of the details. They strike you as a "rag tag" group of scientists -- brilliant, honest, and idealistic -- but without much business experience.

In preparation for your negotiation with Pure Health's attorney on the terms of sale or licensing of Immuno-Pure technology, you met with the Next-Pharm board members. They reached a consensus that money was not as important as making sure that manufacturing continues with as little interruption as possible. They do NOT want articles in the newspaper describing patients' suffering because of Next-Pharm's foot-dragging or greed. They do not want to saddle Pure Health with such debt or high expenses that it is unable to stay afloat. Frankly, they even acknowledged that they would give the Immuno-Pure patents to Pure Health for free if necessary to insure its continued production into the future.

The goal is for Next-Pharm and Pure Health to be successful, and for Pharmalux to remain so. You know that advocates of State and City economic development have strongly encouraged pharmaceutical industry there. It brings high-level marketing executives and scientists into the city, as well as employment for support staff, IT, and lab technicians. Even pharmaceutical manufacturing fits well within an urban location because it tends to be clean and relatively quiet. More opportunities for cutting edge scientific R&D and engineering helps retain University trained scientists and attracts outside talent to the community.

On the other hand, the board also directed you to negotiate for Next-Pharm's interests as strongly as you reasonably can - defining "reasonably" as not impeding Pure Health's ability to succeed, but

also not selling “too short.” At some level, board does not want to face criticism in the future for having sold Immuno-Pure too cheaply, if Pure Health ends up reaping enormous future profits.

Obviously, a higher price and better terms will benefit Next-Pharm. The more resources Next-Pharm has, the more successful it will be, the more research it can support, and the more products it can develop.

In fact, Next-Pharm could use an immediate significant cash infusion to fund a new research project of some promise. For this project, Next-Pharm would like to create lab space in a downtown building owned by the University. Recently, the University had considered selling the property to private developer, but Next-Pharm convinced University officials that it was too good a location to let go. A sale of Immuno-Pure technology for \$2 million would meet the minimum cash needs for funding the first research phase and rehabbing a quarter of the building space -- all that Next-Pharm will need in the near term. Obviously, more funds would be better.

The Next-Pharm President (proudly) told you that Next-Pharm has already recouped most of the \$5 million invested to develop Immuno-Pure and Immuno-Plus from royalties on Pharmalux sales, and it will continue to earn on Pharmalux sales of Immuno-Plus. Next-Pharm could not have developed Immuno-Plus without its prior investment in Immuno-Pure. Anything you negotiate for will be found money.

Regarding ways the transaction could be structured:

You do not know whether Pure Health would prefer to buy the patents for the Immuno-Pure technology outright or to license the right to use them, either through set licensing fees or royalty percentages based upon gross sales.

An outright sale (at the right price) would provide welcome cash to Next-Pharm. Still, you don't see it as in Next-Pharm's interest to sell the IP outright if the price is too low. And you doubt the Pure Health group will have raised much cash or will be able to risk a high up-front payment before production and making sales.

If an outright sale is not possible or advantageous, Next-Pharm is also open to a licensing or royalty arrangement with Pure Health. Again, you will be influenced here by Pure Health's constraints. Next-Pharm's President has said it would be great to have \$400,000 to \$500,000 in annual licensing fees to support Next-Pharm's other research efforts. If Pure Health is concerned about risk of a set licensing fee, your client would be open to royalty structure, based on Pure Health's gross revenues from Immuno-Pure. You (and your client) would want to see projections, but if \$10 million were projected in the first few years, your client has indicated that a royalty percentage of 10% might seem fair. The percentage might go up as sales increase.

You are open to negotiation on all of these numbers, because you want the Pure Health team to get going and to succeed. You are concerned that production delays will cause Immuno-Pure patients to suffer needlessly. Of course, you want to structure a deal that also serves Next-Pharm's current and future interests