



# VALUE PHARMING NEGOTIATION

## Teaching Note

Is the author of many simulations allowed to have favorites?  
If so, Value Pharming is one of them.

This is a two party case, to be negotiated between counsel for Next- Pharm, a joint venture between the State University Bio-Medical Research Department and Pharmalux, a pharmaceutical company. At the time the joint venture began, Pharmalux could have been accurately characterized as “small and young but a promising company.”<sup>1</sup> Since then, Pharmalux has done quite well. The

Next-Pharm’s advisory board included representatives of Pharmalux and the University and of the city and state’s business development offices. It draws on the expertise of State University’s bio-medical graduate students and professors for research design, implementation, and product development. Next-Pharm owns the intellectual property. Proceeds from selling or licensing the intellectual property are distributed back to State University and Pharmalux, after setting aside funds needed for research projects. Drug and drug delivery systems developed and designed are produced, marketed, and sold exclusively by Pharmalux.

If Pharmalux discontinues production of a Next-Pharm patented technology, the rights to license or sell the technology revert back to Next-Pharm, Next-Pharm then 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.

Recently, Pharmalux decided to discontinue Immuno-Pure, a drug that boost the immune system in immuno deficient patients. Immuno-Pure’s extremely pure and efficient manufacturing process is extremely expensive. Next-Pharm has opted to continue producing only Immuno-Plus, intended for the same purpose. Because Immuno-Plus uses far less expensive manufacturing process, it can be priced lower and still yield much higher profits. Most patients tolerate Immuno-Plus well, but a small subset suffer debilitating symptoms from it. When a group of these patients learned of the

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<sup>1</sup> 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.



decision to discontinue Immuno-Pure, they immediately began stockpiling supplies and contacted anyone they could plead with at Pharmalux.

Moved by the pleas of the Immuno Pure patients, a group of scientists from Pharmalux decided to break off and start their own company, called Pure Health.

The negotiation is between attorneys for Next-Pharm and Pure Health. Both sides have an interest in making sure that Immuno Pure can be manufactured and sold by Pure Health, without interrupting patients' ability to obtain the product.

The simulation suggests that an agreement could be a simple sale of intellectual property, or possibly a licensing arrangement. If the representatives don't question their initial assumptions, there's an enormous ZOPA both for a straight sale and for licensing fees. Theoretically, Next-Pharm would sell the IP for nothing - \$0 - but a guarantee of continued production for the patients who desperately need it. Pure-Health's "rag tag bunch of scientists now have venture capital financing and could pay up to \$8 million for a straight sale. They strongly prefer an outright sale of the IP to obtain clear ownership of any derivative product.

However, if Pharmalux insists on a licensing arrangement, 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.

As a practical matter, to make it all work, the Pure Health scientists would need to be released from their non-competes.

There are also opportunities for collaboration, in that Next-Pharm may assist with laboratory space needs and interim manufacturing, since both parties have an interest in maintaining production and distribution to patients. There could be internships for bio-medical graduate students and all of that.

Fundamentally though, there are several important aspects to this case:

- 1) It rather dramatically proves that negotiators should begin with strong assumptions about the other side's circumstances and interests. Assumption render us blind, deaf, or unable to process possibilities of the opposite being true. In this case, Next-Pharm is set up to believe Pure Health is a rag tag bunch of scientists who, of course, would prefer a licensing arrangement. They couldn't have significant capital – right? (Wrong.) And Next-Pharm appropriately wants Immuno Pure to succeed so that it will continue to provide Immuno Pure. Next-Pharm is willing to bend over backwards to make that happen. After all, Immuno Pure was developed in a public-private venture, partially funded by public monies. It's not right that citizens be deprived of the drug they need.

These priorities are valid. However, IF it turns out that Pure Health has capital and will be wildly profitable (as is clear from Pure Health's facts), Next-Pharm shirks an obligation to the public to obtain value for its ongoing bio medical research.



Before making assumptions, negotiators should formulate HYPOTHESES about what the other side's circumstances might be and ask questions at the beginning of the negotiation.

- 2) When the other side's stated request or preferences is entirely different than what you had assumed of hypothesized – hold everything, take a break, reassess.

In this case, it's reasonable for Next-Pharm to think (assume or hypothesize) that the Pure Health scientists will prefer a licensing arrangement, or some structure that doesn't require a large upfront investment. That's based on knowing them as a "rag tag bunch of scientists" who will have some start-up costs. As soon as the Next-Pharm negotiator learns that Pure Health prefers a straight cash deal, bells should ring! The generic advice is that when the opposing party expresses an interest or preference very different from what you had anticipated: stop! It means that you missed something and/or you are operating under mistaken understanding of their circumstances. The best advice is to take a break, give yourself time alone (or with your team) to process and consider questions. Or, if you have the presence of mind, you can ask questions in the moment – be curious and follow the thread. (Gee, I'm surprised you'd rather have a straight-up cash arrangement. Do you have access to capital? How?)

- 3) In my view, once Next-Pharm learns that that Pure Health has significant capital funding, and especially if they learn about plans for derivative technology, Next-Pharm's preferences and goals shift significantly. Frankly, they become much more competitive. No, Next-Pharm doesn't want to diminish Pure Health's chances of success. Surely not. But Next-Pharm does have an obligation to the joint venture partners (including the public) to try to negotiate a generous financial return. After all, Next-Pharm did make the initial investment – in funds as well as publicly funded research professors and students. That's why Next-Pharm is justified in seeking significant up-front cash, as well as a share of future profits in Pure Health's derivative products and technologies (if not from Immuno Pure revenues). Think about it, how does it look if Next-Pharm takes a pittance for an outright sale, and ten years from now, Pure Health's profits are in the billions, built on Next-Pharm IP and technology. A great investigative reporter will make quite a splash with that article.
- 4) The facts also allow for some useful discussion about when and whether to disclose information, and when to be prepared to handle predictable inquiries. Pure Health's venture capital financing is just one example. If the Next-Pharm folks ask about whether Pure Health has financial backers, lying isn't permitted. However, a negotiator can easily say something such as: "You know we are scientists, so we had to get some backing. But of course, they are very concerned about financial risk too. That's why our team needs to ensure this agreement won't break us before we start."

On the topic of investment: it's true that Next-Pharm invested \$5 million or thereabouts to develop Immuno Pure and Immuno Plus. Some negotiators use that information as justification for a high price. Watch out for a Pure Health negotiator's astute response: "Surely, you've already recouped that investment. Or, if not, you soon will from Immuno-Plus's high profit margins." Next-Pharm can't truthfully use lost investment as a price justification. Better to anticipate this, and note that successful drugs generate returns on investment, and as purchasers of Immuno-Pure, they are receiving part of those returns. Then retreat to Next-Pharm's obligation to the public to fund future research, etc.



Regarding anticipated derivative products and technologies: perhaps it's best for the lawyer not to know too much. Most non-IP conversant students neglect this area, but some will ask questions about whether Pure Health plans to develop other pharmaceuticals. Be ready. A lawyer can't disclose client confidences but can't misrepresent a material fact either. Try to move the conversation back to Immuno Pure.

- 5) While I don't pretend to any background in IP, and certainly don't require it of the negotiators, I see some lawyering issues – negotiation issues – regarding protection of client interests, as well as a possible conflict.

First, on the lawyering front, the Next-Pharm lawyers MUST at minimum secure an agreement that the Immuno Pure IP reverts back if Pure Health ever decides to discontinue manufacturing. And acting on the public's behalf, it wouldn't be a bad idea to set some price limitations (thinking of the history of insulin in the US). Students almost never catch the reversion of rights as necessary, but it surely is.

There's an interesting potential conflict for Next-Pharm negotiators. They represent a joint public-private venture, but the joint venture's private partner – Pharmalux – would have legitimate concerns about competitive products Pure Health might develop. Pharmalux might want the “rag tag scientists” to be prohibited from competing (for the two year term) by working on any products OTHER than Immuno Pure. That would not be acceptable for Pure Health, or it would surely lead to lower value and lower payment terms. But Next-Pharm does not share the same concerns about future competition, particularly with respect to other products. It's a worthy topic of discussion.

In the last several years, I have had students record their Value Pharming negotiations, while being observed by another student pair with access to both sides facts. I put them in foursomes, two pairs of two. Each has the full set of facts for the case they are observing and recording. The observers provide feedback to their peers, and I later review the video as well. We debrief both negotiation simulations in the following class session. It works wonderfully well, as the observers see exactly how their classmates fall into the traps set by the simulation.

Rest assured: it's not necessary to use the simulation in that way. For many years, I used a version of Value Pharming in various negotiation workshops and it always works well. The wide ZOPA, the power of information, and the costs of relying on assumptions all work for never-fail debriefing. I do plan to include the non-lawyer version in my collected on-line simulation offerings.