INDEPENDENT IMMUNITIES
NEGOTIATION

General and Pure Health Information

General Information

Not long ago, Prometheus Pharmaceuticals International adopted a strategic business plan to focus on developing and marketing higher-profit drugs. They seek to maintain high stock prices and increase funding for R&D for new drugs. Prometheus will discontinue production of lower profit margin drugs that benefit only smaller patient populations.

One drug to be discontinued is Immuno-Pure ("Pure"), which boosts the immune system in immune-deficient patients. Pure uses an extremely pure, costly manufacturing process. Though Pure is priced high, its profit margin is modest. Prometheus will expand production of its other similar drug, Immuno-Plus ("Plus"). Plus uses a far less expensive manufacturing process and thus will yield higher profits than Pure. Most of the patient population tolerates both drugs well. However, a minority of patients develop debilitating headaches and nausea from the less expensive Plus. Most insurers will only pay for Plus, absent physician verification of a patient's serious adverse reaction.

A month ago, Prometheus authorized the Pure marketing team to announce that production of Pure would cease within the next few months so that customers could stock up. Since then, Prometheus has received many entreaties from Pure patients to reconsider the decision, because they fear painful and debilitating reactions to the Plus drug. There is no other source of Pure.

In response, a group of five Prometheus scientists and business managers announced that they would like to leave Prometheus to launch their own company, Pure Health, committed to producing Pure. However, they know that Prometheus holds patents on both Pure and its distinctive manufacturing process and that they are bound by Prometheus's standard non-compete agreements. Two weeks ago, Pure Health approached Prometheus about the idea, emphasizing that unless the Pure Health group were permitted to produce Pure, some patients would suffer terribly and needlessly. Prometheus indicated that it was open to discussing a deal. Last week, representatives met and agreed upon the following basic elements of a deal:

- The transaction would be structured as an exclusive licensing of the Pure process and manufacturing patents, with royalties to be paid to Prometheus by Pure Health. Prometheus would have preferred a non-exclusive license, but this was a deal breaker for Pure Health. Prometheus ultimately agreed to an exclusive license.
- The Pure Health team would be released from their current non-compete agreements, which extend to intravenous pharmaceutical products manufactured by Prometheus. Prometheus has agreed to continue manufacturing Immuno-Pure, and to sell it to Pure Health at cost-plus 10%, for an interim period to be negotiated. The idea is to enable Pure Health to get its facility up and running.
- These issues will not be revisited in future negotiations about the terms of the deal.

At the end of their meeting, the parties agreed to meet again to see if they could work out additional major issues. This negotiation is about to take place.

Confidential Information for Pure Health

The idea to leave Prometheus and form Pure Health came from a Pure patient, a mother with a genetic immune deficiency, inherited by her son. When she learned of Prometheus' plan to discontinue Pure, she contacted Prometheus managers to plead: "Don't just abandon us and the other Pure patents. Give them to us, we'll get it made." The woman's plea was compelling to you and the chief Pure scientist, a production engineer, a product manager, and an Assistant VP for finance. You met as a group several times, decided on the "Pure Health" name, and hatched a rough business plan. The finance guy has since lined up tentative venture financing through a business school friend.

You were very much encouraged about Pure Health's prospects in your initial meeting and negotiation. The four additional major issues remaining for negotiation are discussed on the pages that follow. The Pure Health team has arrived at a scoring system for possible results on these issues. This scoring system is intended to help you decide how to trade off or compromise on issues to get maximum benefit for Pure Health.

Royalty Percentages

The royalty percentage paid is important for Pure Health's business success. Pure Health would like to pay the lowest royalty possible. Based upon past experience you assume that Pure will generate approximately $20 million in gross sales revenues per year, with a 20% or $4 million profit margin per year (before royalties), when using current manufacturing methods.

Royalties would be calculated based on gross sales revenues. Thus, a 5% royalty per year on $20 million in sales, would cost approximately $1 million and would reduce the profit margin from $4 million to $3 million. You doubt Prometheus would agree to royalties lower than 3%. For Pure Health, royalties in the 3% or 4% range would be fantastic, because this would permit early investment into the development of an exciting new product, perhaps enabling them to "beat the business plan." You are confident of Pure Health's ability to meet the business plan with royalties of up to 7%, and you simply cannot afford to pay more than a 10% royalty. Your points at various royalty levels are set out at the end of these instructions.

Sole or Shared Rights to Improvements

Pure Health's science and engineering team are convinced that with a modest investment in experimental work, they could engineer improvements to reduce the cost of Pure and make its process applicable to other pharmaceuticals. Thus, you want to negotiate for Pure Health to keep (unilaterally) or at least benefit from all product and process improvements it develops that are related to the Pure drug.

(a) Pure Health's keeping the sole right to sell improvements without having to make them available to Prometheus is *very* valuable.

However, if necessary to secure other favorable terms, Pure Health would agree either to:

(b) Give Prometheus the right of first refusal to purchase or license back improvements at a fair market price or

(c) Give Prometheus the right to improvements at no cost to Prometheus, although this would be less valuable. (You could use this to argue for a lower royalty price).

Specific points for options (a), (b), and (c) are given in the Scoring Guide.

Marketing VP and Waiver of Non-Compete

The only key player the current Pure Health team has lacked is a marketing vice president. The team was delighted when Donna Michaels, a Prometheus Marketing Director, expressed interest in joining Pure Health. Donna is brilliant, experienced, talented, energetic, and effective, and has turned the Prometheus marketing department around.

Michaels' non-compete agreement is quite broad, however, barring her from "marketing, strategy, or management in any pharmaceutical company, or company that develops, produces or distributes products relating to pharmaceuticals in the U.S. for five years." Prometheus might be tough about enforcing it.

You want the broadest waiver possible of Michaels' non-compete. (This was not an issue for others on the Pure Health team.) This is important because one of the Pure Health scientists has a new idea for a delivery system for a wide range of drugs. His proposed technology is entirely different from that under development at Prometheus. It must remain secret and it is a long shot, but you wouldn't want Michaels' non-compete to get in the way. Options include:

(a) A limited waiver of Michaels non-compete that applies only to intravenous products: This is the least valuable.
(b) A complete waiver would be much more valuable.
(c) If the Michaels received a complete waiver, but it only took effect after the first year, it would be nearly as valuable because the new product wouldn't be ready for marketing within the first year.

Specific points for options (a), (b), and (c) are in the Scoring Guide.

Length of Interim Production

Prometheus has agreed to continue to produce Pure (and sell it to Pure Health at cost plus 10%) for *some* interim period because it recognizes that Pure Health will need time to get new production facilities up and running. Since your initial discussion, you have investigated the availability and cost of other facilities. You have located an existing facility at a fairly high price which will be available and could be adapted for Pure production in 6 to 8 months from now. Pushing to the earliest completion in 6 months would require Pure Health to incur some overtime expenses, and perhaps some glitches at the beginning of production, but you would do it if you had to.

A better alternative would be to negotiate for interim production by Prometheus for 17 months to 2 years. You have located a larger and more reasonably priced facility, in a somewhat better location, that will not be available for a full year. This facility would require more extensive retooling which will take a minimum of 6 months (on an expedited schedule), and up to a year on a preferred schedule. Specific points for various periods are set out in the Scoring Guide.

Bottom Line

If you cannot reach a deal that is worth at least **300 points**, the Pure Health venture will not succeed. Try to negotiate the best deal you can for Pure Health.

Scoring Guide
Royalty Rates

Royalty %	3%	3.5%	4%	4.5%	5%	5.5%	6%	6.5%
Points	210	180	160	140	130	120	110	100

Royalty %	7%	7.5%	8%	8.5%	9%	9.5%	10%	10%+
Points	90	70	60	50	40	30	20	-200

Future Improvements

Sole right to improvements for Pure Health	100
Right of first refusal to Prometheus	70
Free license to improvements to Prometheus	50

Michaels Non-Compete

Limited waiver for intravenous products only	30
Complete waiver	80
Complete waiver, effective after one year	75

Length of Interim Production

Six months	10
One year	20
Eighteen months	80
Two years	100

Your minimum required score to settle is 300 points.