

# Forging Successful Strategic Alliances for Life Science Companies

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No technology or life science partner should enter into an exclusive licensing arrangement without receiving monetary consideration for the license. They must also be willing to collaborate, accept compromise and marshal resources.

The odds are against most companies. Although strategic alliances or corporate partnerships have attracted popularity over the last decade, these corporate marriages are fraught with failure. By most anecdotal evidence, pundits have speculated that two-thirds of alliances have imploded, typically within the first twelve months of signing. If these ventures are so prone to failure, what preventative measures can a company employ to ensure success?

## THE ALLURE OF AN ALLIANCE

A strategic alliance is not just a contract; it is a combination of profoundly human dynamics. The strength of an alliance often resides in the crucible of human relationships, diplomacy and politics, similar to a marriage. Like a marriage, for an alliance to succeed, strategic partners must communicate their goals consistently and clearly throughout the process, from courtship to union. They must also be willing to collaborate, accept compromise and marshal resources. In order for a corporate alliance to succeed, there must be a consistent message of collaboration, milestones to measure performance against expectations and forums for resolving disputes. Like many marriages, corporate divorce frequently results when goals and needs are not communicated, when surprises corrupt expectations or when there is adultery with competitors.

## REASONS FOR THE ALLIANCE

For smaller companies, the strategic alliance offers an opportunity to marry their human capital resources, rapid product development cycles and robust intellectual property portfolios with the manufacturing muscle, distribution horsepower and installed customer base of a larger partner. These benefits often come without deploying financial capital.

Indeed, for many companies in the life science and medical device sectors, this paradigm is often an attractive alternative to venture financing. The larger company acquires, by license, the intellectual property portfolio of the nimble development partner without incurring the heavy cost and long years of product research. That R&D burden has been cast on someone else's nickel. The distribution partner gains a window on technology, and the technology partner gains access to marketing channels—without incurring stockholder dilution through an equity financing. Everyone's a winner.

### Exclusivity: No Pain, No Gain

Many alliances are structured upon exclusive arrangements. For the smaller partner, however, exclusivity can be a blessing with many curses. For example, the smaller technology partner may grant an exclusive worldwide license to an entire intellectual portfolio to the distribution partner. If the smaller partner receives no financial commitment for this license, whether as an up-front license fee or prepaid royalties, it has essentially mortgaged its future. An exclusive arrangement without an appropriate balance of risk and reward for each partner effectively

converts the smaller technology partner into a “captive” R&D subsidiary of the larger partner. No technology partner should enter into an exclusive licensing arrangement without receiving monetary consideration for the license.

Alternative structures include up-front license fees, advances and recoupment against future revenue streams, or commitments to advance prepaid royalties against development milestones, including the achievement of domestic and foreign patent issuances or regulatory approvals. Larger partners often want exclusivity without paying for it. The smaller licensing partner must negotiate some financial pain for the licensee’s gain.

#### **Rights of First Refusal: Keeping the Predator Away**

In addition to demanding exclusivity, distribution partners often require a right of first refusal (ROFR) on product improvements, new product developments, or new fields of use or market sectors. If the distribution partner has provided up-front payment for the exclusive license, an ROFR appears a rational proposition. For the technology partner, however, the ROFR has a pernicious consequence: that right becomes the ultimate poaching right for the distribution partner. The ROFR provides the distribution partner with a right to match competing offers from interested third parties. If the distribution partner always has the right to match competitive offers, the licensing partner is effectively taken off the market and can rarely conclude a competitive deal with another partner for new areas of exploitation.

Other, potential strategic partners will not be interested in becoming the “stalking horse” if the existing licensee always enjoys the right to match the offered price. From the licensing partner’s perspective, instead of structuring the invitation to bid as a right of first refusal, that partner should consider implementing a right of first offer (ROFO). A ROFO allows the licensing partner to control the bidding process by offering it to the partner for a period of 30 days to accept or reject. This is similar to the “auction” process in the merger and acquisition marketplace.

If the distribution partner rejects the offer, the technology partner then has the unfettered right to seek other partners on the open market without fear of subsequent poaching by the distribution partner. If the pricing bid is lowered, so as to become more favorable to the distribution partner who initially rejected the offer, the technology partner would be compelled to re-open the initial bidding process.

#### **Most Favored Customer Status**

In addition to the right of first refusal, many non-exclusive strategic alliances also contain most favored customer provisions (the “most favored nation” or the so-called “MFN” clause). The MFN provision allows the licensee partner to retroactively re-negotiate the transaction if the licensing partner consummates a new, non-exclusive arrangement involving improved economics, license grant, warranty, support or other material terms with another party. In other words, if the new arrangement contains pricing more favorable to a third party, the licensing partner must re-price the original transaction with the first licensee and supplant the original terms with the new, more favorable arrangement.

The MFN provision could have a potentially disastrous impact on the licensing partner’s ability to broaden its distribution channels and structure alternative arrangements, as well as control pricing changes as the product or market evolves. Care should be given to the legal language here. Accordingly, when pushed hard in negotiations, the licensing partner could offer the MFN provision but ensure that retroactive pricing will only be provided involving situations with “substantially similar transaction structure, with substantially similar financial commitments and product volume commitments, over substantially similar periods.” In other words, once the new structure departs on any material term, the MFN provision is revoked.

#### **Termination: No-Fault Divorce**

Because most alliances fail, the licensor partner would be well-advised to plan for the exit. One of the more conventional pathways for exit is the “no-fault divorce.” If the distribution partner fails to achieve pre-determined sales volumes or other commercial milestones, then the licensing partner can unilaterally unwind the alliance. The critical question, however, in the no-fault divorce scenario is whether the licensing arrangement will simply be converted from an exclusive to a non-exclusive license, or whether the licensing partner can terminate the license entirely and seek another exclusive arrangement. If the licensing partner can only render the license non-exclusive, it will not be able to re-leverage the technology and obtain the same initial licensing value if multiple market players are invited. The marketplace is the best arbiter of value—but a crowded playing field lowers value. If the technology partner can reclaim exclusivity, it retains the right to extract improved value by offering exclusivity to the next partner.

Alliances can be structured for success. Careful, prior planning on these potential issues is an important factor in that process.

To discuss strategic alliances in more detail as they may pertain to your business, please feel free to contact [Stanley F. Chavire](#).