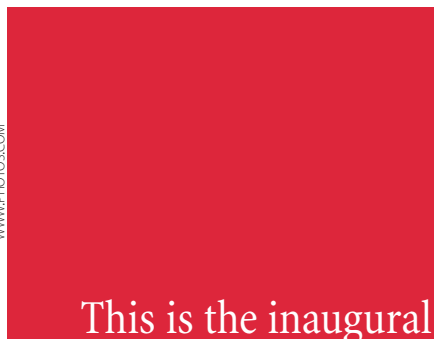


# He Should Have Armed Himself

By Raymond S. Fersko



This is the inaugural BioSciLaw Insight column, a tool to enable your business strategies and protect, develop, and promote the products and processes resulting from your innovation.

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In the movie *The Unforgiven*, a reformed gunfighter played by Clint Eastwood walks into Greeley's Saloon asking "Who's the fellow who owns this s\*\*hole?" Skinny says tentatively, "I—I own this establishment." The gunfighter turns to Skinny and shoots him. The first comment heard is, "You shot an unarmed man." The gunfighter's taciturn reply: "He should have armed himself."

No executive wants the board or shareholders to say after it's too late: He should have armed himself with the tools that were available. He should have considered all the business and legal issues relevant to enable successful strategic agreements.

## PUT ALL YOUR CARDS ON THE TABLE

Biotech executives need to be armed with basic principles at the outset of any agreement so that when lawyers get involved they do not have to restructure arrangements that an executive negotiated.

**The First Principle:** No biotech transaction should be entered unless each party can document the intellectual property brought to the table by the other.

It is of great importance that all sides identify intellectual property ownership at the beginning of any strategic partnering agreement. Most strategic biotech agreements terminate without reaching final commercialization stages or intended research goals. (The typical agreement has three stages, research, development, and commercialization.)

When an agreement terminates, all parties must agree who owns the data generated and who is responsible for any new know-how, trade secrets, patents, patent applications, and technical information. All that intellectual property is up for grabs unless its ownership was carefully documented at the outset of the agreement. If ownership is known at the start, anything new is owned either jointly, individually, individually with a third party, or jointly with a third party.

## REACHING YOUR DESTINATION

Every agreement has an endpoint, such as efficacy resulting in the shrinkage of a tumor. Once parties agree on an endpoint and financial arrangements, the most important part of the agreement describes the rights of the parties if there is termination. In biotech, most agreements terminate before their intended endpoint because of difficulty encountered in demonstrating efficacy.

Why else do agreements terminate? Some complete their term. Others end with the bankruptcy of a party, breach or other default, change of control of a party, failure to achieve milestones, mutual agreement, alliance success, an IPO, a third-party offer for one of the businesses, a deadlock, and sometimes just a clash of personalities.

**Avoid the 150% Rule:** When you terminate a relationship for any reason,

don't make the mistake of asking what the other party wants or needs. What the other party wants and needs is usually 150% or more of what is reasonably available. Given a realistic assessment of the parties' economic positions and/or scientific strengths in connection with a project (including the strength of the intellectual property), the golden rule generally applies—he who has the gold rules. The gold may be money or science, but in every agreement one party is in a stronger position than the other.

Parties that wish to have rights in termination must be willing to give concession in the form of money, other rights, or a combination. Among the many issues to consider are continuing manufacturing by one party, different uses for know-how and other intellectual property, each party's ability to partner with others, and further research.

### **WHAT DO YOU WANT TO GET?**

Questions and issues each party may want resolved upon termination include the following.

- Who gets the IP rights?
- How should each party plan for financial contingencies and commitments?
- What obligations should survive the termination?

Specific potential obligations to consider include joint ownership of IP; who continues patent prosecution and what each party gets at each stage; the exercise of options, rights-of-first-refusal, and rights-to-negotiate already given; intercompany transfers; confidential information (what to do with it and for how long); indemnification; escrows for contingencies; rights to opt out of a project with a methodology for buying back in; and tax implications.

Other issues to consider when terminating an agreement include human resources issues; responsibility for biohazardous substances; regulatory issues; research rights; division of intellectual property regarding exclusivity, territory, and field of use; a period during which options remain open; and a negotiated methodology for different valuations.

### **WHEN IN ROME . . .**

International transactions have their own special set of rules, based on practical, cultural, and legal considerations. There is a growing consolidation of the civil law practiced in most European countries, South American countries, and former colonies of European nations other than England.

**But Get a Copy of the Code in Your Native Tongue:** Do not enter into an agreement governed by another country's laws without having a lawyer from that country vet the agreement. Always get a copy of the civil code of the country involved so you can discuss it with your local counsel to make sure everyone is considering the same issues and

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≈1 *Bloor v Falstaff Brewing Corporation*, 601 F.2d 609 (2nd Cir. 1979).

understands the intentions of all parties. You should arm yourself with all the knowledge you can find about contract law in the relevant country because even laws that look similar can be interpreted quite differently.

One example: The “Whereas Clauses” in common-law agreements are generally considered outside the contract insofar as obligations are concerned. In the absence of a latent ambiguity, in common-law countries, if it isn’t within the four corners of the document, it isn’t part of the contract.

On the other hand, in civil-law countries, fact finders look to the Whereas Clauses and parole evidence (oral testimony to modify, vary, explain, or contradict the plain terms of a valid written contract between parties) to ascertain what the parties wanted when entering the transaction. Civil-law fact finders may try to reform an agreement so the perceived desires of the parties determine the outcome of a dispute even if the obligations were not clearly spelled out.

Another potential conflict is how a different meaning can be ascribed to the same terms. A good example is best efforts. In the United States, particularly in New York under the seminal case of *Bloor v Falstaff Brewing Corporation*, “best efforts” means a company does everything short of putting itself into bankruptcy to meet the obligation of an agreement ≈1. In *Falstaff*, it was held that the purchaser of a brewery did not use its “best efforts” when it reduced its advertising budget after an acquisition.

In some civil-law countries, such as Switzerland, the term “best efforts” entails less than full performance. You do your best, and if you do your best, you may not be held responsible for an actual obligation that has not been met. When it is the other parties’ obligation, leave it out in Europe, put it in in the States.

### THE ONLY TWO CERTAINTIES

The old adage that there are two certainties in life—death and taxes—applies to all agreements.

Any agreement requires an analysis under applicable tax laws for structuring at the very beginning. Without such planning, your agreement might just as well be dead. In some countries, royalty income from another country is taxed at a lower rate than other income or is not taxed at all. For example, there is a withholding tax of 30% on royalties moving between Italy and Luxembourg, but royalties moving between Italy and the Netherlands are subject to only a 5% withholding tax. The Netherlands has no withholding on royalties upstreamed to Luxembourg, provided a real operation is in the Netherlands. There is generally no tax on royalties in Luxembourg.

In some countries, it is also possible to negotiate the tax if a project results in royalties. Many other incentives are available if operations are conducted within a particular country (rather than between countries).

## LITIGATION IS THE LAST RESORT

No matter how difficult a problem, always look for a practical way to resolve it short of litigation. Litigation is generally yesterday's business—an expensive, time-consuming diversion from new business that has no guarantee of positive results. Different judges or juries make a big difference in how litigation is carried out and, often, how it results.

In the United States, Europe, and Asia, public policy favors arbitration. Having an arbitration award recognized and enforced in civil-law countries is generally less cumbersome than enforcing court judgments because of international treaty obligations.

The rules for dispute resolution are essential to any good agreement. That includes interim disputes as well as those that arise when an agreement is over. All parties need rules to guide them.


A good arbitration clause lays out the criteria for choosing the arbitrators, tight deadlines, the applicable law, the conflicts-of-law rules, and the location of a hearing. If only a number is needed, *baseball* or *night baseball* arbitration is often recommended.

In baseball arbitration, the parties exchange their own prechosen figures of the value of a case or the issues in contention, and the arbitrator must choose one figure. The arbitrator will assign a value to the case, and the parties agree to accept the high or the low figure closer to the arbitrator's value.

In night baseball, the arbitrator does not know what figures the parties have selected. The ultimate award will be the number selected by either party that is closest to the selection of the arbitrator working in the dark.

These procedures bring parties that are far apart together and make them take realistic positions about their cases. Lately I have seen baseball arbitration clauses with greater frequency than in the past, governing disputes of all kinds in biotech agreements—particularly those between platform tool technology companies and those who use the tools to create a product.

Because arbitration has become such a widely used means of dispute resolution, the next column will continue to discuss it. It will also review how the devil is in the details when it comes to the actual drafting of agreements to avoid disputes or provide self regulation to the extent practicable (providing for every possible permutation of every issue).

Send questions you would like to see addressed in future columns and comments about this installment to [rsfersko@bioscilaw.com](mailto:rsfersko@bioscilaw.com). I will devote a part of future columns to answering readers' questions. 

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