Joint Ventures and Intellectual Property Assets

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Companies seeking to enhance their intellectual property assets sometimes choose to collaborate with another company. Collaboration may be appropriate, for example, for a company seeking to share risk, conduct a one-time special project, or gain the benefit of skills and IP assets belonging to another company, without the obligations of a merger or acquisition or the time it takes to negotiate and execute such a deal. This can be particularly useful where speed is important to enter into a new market before competitors can gain market share, for example. Collaborating companies can always decide later to solidify their relationship by merger or acquisition. For a more detailed discussion on mergers and acquisitions, see *Acquiring IP Assets*.

Most corporate collaborations involve the formation of some kind of joint venture relationship. Joint ventures can be useful for example where different companies bring different skills to the table on a particular project. For example, one company may have the engineering know-how and the other the marketing know-how. Or, one company may have the ability to manufacture a unique fabric and the other the ability to turn that fabric into specialty clothing.

Formation of the Joint Venture

A joint venture (or "JV") relationship is generally formed in one of two ways. First, the companies may enter into a contract, forming a purely contractual relationship. A contractual collaboration between companies is sometimes referred to as a "strategic alliance," "corporate partnering" or "corporate partnership." Second, a separate legal entity may be formed to carry out the JV relationship, with the companies sharing ownership interest in the new entity (often referred to as an "entity-based" joint venture.)

Where the joint venture's objective is to join forces in developing IP assets, the parties typically enter into a written contract known as a joint development agreement or "JDA." The JDA memorializes the agreed-upon details of the joint development arrangement and is useful regardless of the joint venture structure. Where the joint venture is contract-based, the JDA may be the only operative agreement between the parties or it may be a supplemental contract to the parties' overall joint venture agreement. Even where the parties have formed a separate entity to carry out the joint venture, it may be wise to enter into focused JDAs for specific development projects, particularly where the parties intend to engage in several different development projects. Each project may have different requirements and may require the donation of different materials or skills by each party; thus, different JDAs for each project may be advisable.

Thus, at the outset, the companies must determine the form of JV structure will be most appropriate for their proposed collaboration. This decision will be based on numerous factors outside the scope of this guide. At the very least, however, the parties should consider the tax, accounting, regulatory and liability issues associated with forming a new entity vs. entering into a contract. See *Checklist — Forming Joint Ventures and the Treatment of Intellectual Property Assets*.

The JV's Purpose

It will be very important to identify and describe the JV's purposes, goals, and objectives. If the JV's purpose is described too broadly, it can lead to misunderstandings between the parties as to the scope of the joint venture as compared to the separate businesses of the JV partners. This will be particularly important where the JV partners are competitors. The best practice is for the parties to define the JV's purpose in as much detail as possible, taking into consideration important issues that will relate to the scope of the JV's business activities such as non-competition and ownership of the IP assets. Obviously, over time, that purpose may change and the parties can revisit the agreement to revise the description.

The parties should also address such issues as the term of the venture, whether the JV is formed for a specific one-time project or will be a continuing concern, and whether there are any territorial limitations to the venture.

The parties should also review the JV's business objectives to determine whether any additional agreements are necessary to carry out the JV's purpose. For example, if the JV will be utilizing certain IP assets owned by one of the parties, or licensed by one of the parties, then licenses or sub-licenses may be required. See *Checklist — Forming Joint Ventures and the Treatment of Intellectual Property Assets*.

Contribution of Assets to the JV

A primary issue in any joint venture is the contribution each partner makes to the JV project. Each partner's contribution should be clearly defined and can include contribution of assets including IP assets, financing, loaning of employees, and a scope of work to be performed by each partner. Where the work is to be performed, a schedule for the completion of various tasks, and which partner will perform each portion of the work should also be considered. In some cases, specific people will be assigned to the JV project and they should be listed either by name or by title or function, in case there is a change in personnel over time.

One or more of the parties may already own assets, including IP assets that will be helpful or necessary to the JV's development efforts. Additionally, a party may independently create IP useful to the JV during the term of the JV agreement, but outside its parameters. This pre-existing or separately created IP is often referred to as "background IP." In either case, one or more of the JV partners will need to contribute ownership, or at least the ability to use this background IP to the joint venture. This could be accomplished by transferring ownership of the background IP to the JV. More typically, however, the party who developed the background IP will continue to own it separately, and will provide an appropriate license to the JV partner or entity. Such a license will often include a field of use limitation tailored to the specific operations of the JV.

The ability to share background IP assets is important to most joint ventures formed for the purpose of developing new IP assets. But the benefits of business collaboration go well beyond the sharing of IP assets. JV partners have the ability to benefit from contributions of financing, key personnel, expanded distribution channels and marketing power. See *Checklist — Forming Joint Ventures and the Treatment of Intellectual Property Assets*.

Ownership of IP Assets Developed During the Joint Venture

The parties to the joint venture must also determine how they wish to allocate ownership of the IP assets invented, created or developed through the joint venture, sometimes called "foreground IP." In the example above about the ability to make fabric and turn it into specialty clothing, there may be patents on the method of creating the fabric contributed by one partner and know how in turning the fabric into clothing contributed by the other partner.

Where the JV is entity-based, the parties are likely to arrange for the separate JV entity to own the foreground IP. Thus, it is unnecessary to allocate ownership rights to either party or deal with the complexities of joint ownership of IP assets. This is an important benefit of using an entity-based JV structure. Where there is no separate JV entity, however, and the parties' relationship is solely contract-based, the parties must allocate ownership. Generally, the alternatives are (1) joint ownership, or (2) sole ownership by one of the JV partners, with or without a license to the other partners.

Regardless of how the ownership is assigned, the parties should take advantage of the provisions of *35 USC 102(c)*, which provides that sharing of confidential information under a joint research agreement in effect before the date an invention was made will not be the basis of an obviousness determination under patent law.

Joint Ownership

Joint ownership of IP assets, particularly those subject to patent or copyright laws, is tricky. For example, each co-owner of a U.S. patent is ordinarily free to make, use or sell the patented invention without regard to the wishes of any other co-owner. This right to exploit without the need for consent of any co-owner includes the right to grant licenses to third parties.

The facts of one well-known Federal Circuit case illustrate the pitfalls joint ownership can involve. In *Schering Corp. v. Roussel-UCLAF SA, 104 F.3d 341, 344 (Fed. Cir. 1997),* Schering and Roussel had jointly developed and jointly owned the patent. Under the terms of their joint venture, Schering and Roussel were permitted to sue third parties for patent infringement without the consent or participation of the other. Schering and Roussel's agreement did not, however, restrict the right of a co-owner to exploit or license the jointly owned patent without permission or participation of the other co-owner. When Schering later brought a lawsuit against Zeneca for patent infringement, Roussel provided Zeneca with a complete defense to the suit by granting Zeneca a license to the patent.

Any JV agreement providing for joint ownership of jointly developed inventions must carefully address the rights and obligations of the co-owners, and provide for control and accountability between the co-owners. If the parties do not provide for such rights or obligations, the law may provide them in ways the parties do not contemplate; for example, if the right to sue for infringement is not provided, then the law will define who may sue.

Sole Ownership of Developed IP Assets

Some of the more common approaches for allocating ownership to just one party, which can be used alone or in combination with each other, are: (1) inventorship; (2) objective structure; (3) subject matter; and (4) separate entity.

<u>Inventorship.</u> Ownership of the developed or "foreground IP" is allocated to the party employing the people who invented, developed or created it. Thus, JV Partner Company A will own the IP where its employees solely invented, created or developed the IP. Company A would then grant a license (discussed below) to the other JV Partner Company or Companies. The inventorship model is often adopted because it tracks what the patent and trademark laws will provide without an agreement. But it does require that the parties agree upon which party invented, created or developed the resulting IP asset. Although determining the inventor is a necessary part of the patent application process and, therefore, a determination that will have to be made in any event for patentable IP, one can see where it may be difficult (and counterproductive to the JV's spirit of joint development) to draw such lines in the context of a joint venture relationship.

<u>Structure.</u> With a structural approach, the parties make an objective, contractual choice as to which party shall own the entire foreground IP portfolio, rather than having to make a subjective, case by case determination as to the actual inventor or creator of each new invention. According to this objective criterion, one party – either the JV or one of the JV partners – will be granted ownership of the foreground IP, which can then grant a license back to the non-owner partners. One of the simplest structural ownership allocations assigns ownership of all developed IP assets to one party, with a license back to the other parties. This structure is common where one party has significant dominance or leverage in the JV relationship. One JV partner, for example, may have contributed more background IP, personnel or money to the joint venture than any of the other partner companies.

<u>Subject matter.</u> Particularly where the JV partners are engaged in separate and distinct fields, the parties may allocate ownership based on the subject matter of the resulting IP asset. Thus, a new invention arising out of the joint venture that is "primarily related" to JV Partner Company A's field of use or technology will be owned by Company A – and possibly licensed to the JV and/or the other partner. This approach may prove difficult when the companies' respective fields overlap or where the subject matter of the IP asset has applications in multiple fields.

Similarly, the parties may allocate ownership based on the primary origin or derivation of the foreground IP. Newly-developed IP assets derived from or constituting an improvement of one JV Partner Company's background IP would be owned by that party. Like the inventorship approach, however, this approach has its drawbacks. Requiring the parties to determine whether a particular IP asset is a "derivative" of, or an "improvement" of, pre-existing IP may not only be difficult, but a source of dispute between the parties.

Under this approach, therefore, it is crucial for counsel to negotiate and draft clear and workable definitions of each party's distinct fields of use and contributed background IP, as well as how "primarily related," "derivative" and "improvement" are defined. See *<u>Checklist — Forming Joint Ventures and the Treatment of Intellectual Property Assets</u>*.

<u>Separate IP-owning entity.</u> This approach does not allocate ownership to any individual JV partner but rather, assigns ownership to a separate entity in which the JV partners are members – this can be the JV itself or another entity specifically set up for this purpose. Where the entity is formed solely for the purpose of owning the foreground IP (e.g., as a holding company) rather than operating the entire JV operation, an ownership model may be similar to that of an entity-based JV, but could also provide specifics of the rights of the parties if the IP is asserted in litigation.

As with the other approaches above, the IP-owning entity can grant licenses to the individual JV parties where needed. The IP-owning entity may also undertake enforcement actions or license third parties. This structure may be the preferred approach when the JV's primary goal is to exploit the JV's IP assets externally through third parties rather than internally among the partners. This is because administration of a licensing program and infringement enforcement may be carried out more efficiently and effectively by one IP-owning entity rather than piecemeal ownership by the various JV partner companies.

Licensing Developed IP Assets

The parties need to consider whether the foreground IP donated to the JV may be licensed by the JV to others and, if so, under what circumstances. They must also consider whether any IP developed by the JV may be licensed, and if so, under what circumstances.

<u>Field of use licensing.</u> Field of use licensing allows the JV to exploit the IP in a manner that maximizes the core characteristics of

each partner by dividing license rights among various markets or applications, according to each partner's strengths. (It may also be advantageous for the JV to include third party licenses in the mix.)

The critical language of a field of use license is the definition of the licensed field. The field can be defined several ways, including by "application" of the patent. For example, where a new engine for a vehicle is developed, the licensed fields may be cars, motorcycles, trucks or boats. Licenses may also be divided on "market" (e.g., retail versus wholesale) use. Using the same example of a new engine for vehicles, the license may be divided by personal vehicles (cars, motorcycles and small trucks) versus commercial vehicles (delivery vans and larger trucks). Licenses may also be divided by product distinctions (e.g., a drug in dosage versus bulk form).

Geographic limitations. Similar to taking advantage of the JV partners' different fields of expertise, the JV may also want to divide license rights according to geographic area. For example, each partner may have different abilities to market in different geographical areas. The separate geographic license can take advantage of each partner's strengths. The geographic areas could be across the country or the world. However, where the license is to different geographic areas, a determination must be made on how that division will work. For example, if a sale is made over the Internet and shipped to an area not under the license, would that violate the agreement or, would it be considered compliance as long as the sales facilities from where the item is shipped are in the geographic area.

Exclusive vs. non-exclusive licenses. The simplest license is non-exclusive, which provides the non-owner partner the right to exploit the IP asset according to the terms of the license agreement. The IP owner may license freely to others and the non-owner partner has no ability to exclude others from use (or enforcement) of the IP assets.

An exclusive license, on the other hand, generally conveys to licensee the sole right to exploit the IP asset – even to the exclusion of licensor. (Counsel should be aware of the possibility that pre-existing prior licenses or a reservation of rights by the licensor could hinder licensee's right to exclude all.) For a more detailed discussion of such licensing issues, see *Key Patent License Provisions by Michael J. Kasdan, Wiggin and Dana LLP — Exclusive vs. Non-exclusive Patent Licenses*.

Exclusivity is a decision made based on potential revenue. For example, if the invention is an advantage – but not a necessary advantage – to an existing product, the license fees may be small if there are multiple licenses. But if only one licensee is given an exclusive, its sales may jump with this advantage and it may be willing to pay a higher royalty.

The license may be exclusive as to certain limitations but non-exclusive as to others. For example, the license may be exclusive as to certain geographic areas but non-exclusive as to others.

Operating the Joint Venture

If possible, it is a good idea to have both partners to the joint venture participate in its management. However, there may be circumstances where joint management is not feasible or necessary. One such example is where one party donates IP to the JV and the other donates management talent.

Decisions Reserved for the Joint Venture

There are two different types of management decisions that need to be discussed when considering operating issues. The first is the day-to-day operations of the company and the second is non-routine decisions on fundamental issues such as when to sell assets. Once the issues have been divided into these two areas, the parties should agree upon the approval, decision making and voting procedures for both.

Rather than spell out in the JV agreement each and every day-to-day decision that may be decided by the JV's management, it is common for the operative JV agreement to provide that day-to-day decisions may be made by the JV's management, but contain a section detailing the "Reserved Matters" reserved for decision by the JV members rather than the JV's management.

Here are some examples of matters that the parties should consider reserving for decision by the JV parties (vs. management):

- Procedures for developing, approving and updating the JV's business plan and budget.
- Changes in the scope or objectives of the joint venture.
- Standards and procedures for dealing with non-arm's length transactions and other potential conflicts of interest relating to one or more of the JV members and the joint venture.

- Transactions, commitments or contracts outside the ordinary course of business, including investments, in excess of a specified monetary amount.
- Proposed transfers of any ownership interests.
- Proposed purchase or sale of JV assets.
- The makeup of the management vehicle and procedures for appointment of its members.
- The extent of authority given to the management team including whether to reserve certain significant decisions to the JV members.
- The authority to hire, retain and remove senior officers such as the CEO.
- Any changes in capital or other contributions by any of the JV partners.
- Filing by the joint venture under the insolvency laws.
- Commencement, settlement or abandonment of litigation or an admission of liability of the JV involving a dispute in excess of $_______________.
- Commencement, settlement or abandonment of enforcement proceedings to protect or defend foreground IP assets.

See *Checklist — Forming Joint Ventures and the Treatment of Intellectual Property Assets*.

Joint Venture Exit and Termination Provisions

One of the key issues the parties will face when the joint venture ends is how to dispose of (or "de-allocate") the JV's IP assets. The IP assets are typically comprised of IP assets owned by the JV (e.g., the foreground IP), IP assets assigned or licensed in from JV members (e.g., background IP), and IP assets licensed in from third parties. Regardless of the particular type of exit strategy employed, the parties will likely need to negotiate separate provisions for the de-allocation of each of these three IP asset types.

Common Exit Strategies

Some of the most common exit strategies are spin off, a merger or acquisition, and dissolution. To better understand each, it is important to understand that license agreements may be "in-bound licenses" (where the JV is taking a license for the patents of others) or "out-bound licenses" (where the JV is licensing its patents to others).

Spin off. The JV is turned into an independent company, owned by the JV partners but with independent control.

Merger or Acquisition. A common way to end the joint venture relationship involves merger or acquisition of the JV. If the parties anticipate this will be a desirable exit strategy, they and their attorneys should be sure to take this eventuality into consideration when negotiating and drafting any underlying agreements to the JV. To ease the way for a future merger or acquisition, all license agreements should contain provisions allowing for the license to be freely transferable upon change of control. At the same time, individual JV members should prepare for the possibility that one of their competitors may be involved in the eventual merger or acquisition, or that they may oppose the deal for some other reason. In that case, they may want to negotiate appropriate provisions in their in-bound licenses to the JV that will enable them to prevent their IP assets from transferring to the competitor or otherwise unwanted Buyer.

Dissolution. Another exit strategy involves the dissolution of the JV. Although the joint venture itself will cease to exist, the members will likely wish to protect their rights to continue to use the IP assets owned by the JV. Thus, the parties may provide for an automatic allocation of the JV's owned IP assets back to the members upon dissolution. The considerations and approaches to this "de-allocation" of a JV's IP to its members are essentially the same as those for the allocation of the JV's IP assets upon creation. Thus, the alternatives discussed in the above section titled "Ownership of IP Assets Developed During the Joint Venture" will also apply to the dissolution stage and include: (1) assigning the IP assets to the members as joint owners; (2) assigning the owned IP to one member, with licenses back to the other members; and (3) assigning the IP to a separate entity that will act as a holding company for the IP assets and license rights to the members.

The parties may also wish to provide for continued use of those IP assets licensed to the JV by third parties after dissolution. To do so, the third party license agreements must contain provisions allowing for the members' continued use rights after dissolution of the JV. The parties must therefore consider and plan for this possibility at the time they first negotiate any in-bound third party license agreement. Just as with the merger or acquisition exit strategy, these license agreements should address transferability to multiple parties as well as the ability to sublicense.

With respect to the IP assets that were licensed to the JV by individual members (background IP, for example), it is likely that the individual member will want the license to cease upon the JV's dissolution, as the IP asset was contributed only in furtherance of the joint venture's objectives. Once the joint venture has ceased, there is no reason for the other non-owning members to continue to use that IP. Accordingly, the JV agreement will typically provide for the in-bound member license to terminate upon the JV's dissolution, making clear that all ownership and use rights remain with the individual member who initially contributed the background IP asset. On the other hand, if the members wish to protect their right to continued use of the other members' IP assets, they should be sure to include in the JV agreement a right to compel an IP-owning member to enter into new licenses. (The license should be narrowly tailored to the necessary field of use.)

Bankruptcy Issues

Bankruptcy of the Joint Venture

Should the JV itself go bankrupt, the parties' desired de-allocation of the IP assets must comport with the bankruptcy laws as they apply to IP. It is therefore important to understand these laws and use them as a guideline when drafting the JV agreement and any in-bound IP licenses. If necessary, bankruptcy counsel should be consulted. A detailed discussion of IP and the bankruptcy laws is beyond the scope of this section, but the key provisions to be aware of are outlined below.

Bankruptcy law will not permit enforcement of a contract provision triggered by bankruptcy (a so-called ipso facto clause). See *11 U.S.C. § 363(1)*, *11 U.S.C. § 365(e)(1)*, *11 U.S.C. § 365(f)(1) and (3), and 11 U.S.C. § 541(c)(1)(B)*. An example of such an unenforceable provision is: "This license will be cancelled upon entering of either party into bankruptcy." Thus, when drafting contract provisions designed to address a potential bankruptcy, be sure to trigger your provisions not on the bankruptcy itself, but on likely bankruptcy conditions such as poor financial results or failure to pay certain bills.

In addition, the bankruptcy court or trustee may assume and assign any "executory contract" belonging to the bankrupt entity, despite the presence of an anti-assignment or anti-transferability clause in that contract, unless some non-bankruptcy law excuses the non-bankrupt party from accepting performance of the contract from a party other than the bankrupt party. See *11 U.S.C. § 365(c)(1)*. An executory contract is one that requires a party to continue to perform certain acts. Fortunately, in-bound IP licenses are generally deemed personal and, therefore, non-transferable. Thus, to protect your JV's in-bound licenses from assumption and assignment beyond the JV members' control, counsel should take the necessary precautions to have the licenses construed as personal and incapable of being performed by a party other than the joint venture; for example, the license ceases if the JV is no longer owned in part by the licensee or no longer has a certain number of directors who are employees of the licensee. Counsel should draft in-bound licenses to emphasize the IP nature of the license's grant as well as the special skills of the JV to perform that IP grant of license.

Bankruptcy of a Licensor to the JV

Rather than the JV itself going bankrupt, a licensor to the JV may enter into bankruptcy, calling into concern the JV's continued ability to operate without benefit of the license from the bankrupt party. The bankrupt licensor could be a third party or a member. The bankruptcy court or trustee generally can terminate any executory contract. See *11 U.S.C. § 365(a)*. There is an exception, however, for intellectual property licenses. See *11 U.S.C. § 365(n)*. The bankruptcy code defines "intellectual property" as including patentable inventions, copyrightable works of authorship, trade secrets, and mask works. See *11 U.S.C. § 101(35A)*. (Note that this definition does not include trademarks, though some circuits have interpreted it to include trademarks as well.) Accordingly, to help guard against an in-bound license being terminated in the event of a licensor's bankruptcy, counsel should take care to draft the license as involving "intellectual property" as defined by the bankruptcy law and include one or more provisions characterizing the license as "subject to *section 365(n) of the U.S. Bankruptcy Code*."

Protection under section 365(n) is not automatic, however. To take advantage of this section's protection from termination of an in-bound license, the JV must notify the bankruptcy court of whether or not it wishes to elect to retain its license rights (called an election). Counsel should also include a provision in the license agreement requiring the licensor to notify the JV as soon as practicable in advance of filing for bankruptcy and in all events no later than some brief period of time upon filing. Sufficient notice of the licensor's bankruptcy will permit the JV to notify the bankruptcy court of its election to take advantage of section 356(n)'s protection from termination of the in-bound IP license.

Joint Venture Termination Provisions

A joint venture relationship may also terminate simply according to the terms of the underlying JV agreement. Termination can be tied to a particular period of time, a calendar-based time period that acts as the formal term of the parties' agreement to collaborate. Termination may also be tied to the accomplishment of certain tasks. For example, if the JV is formed for the purpose of developing product improvement X and new product Y, the joint venture partners may provide for the JV agreement to terminate once both products X and Y have been fully developed. Since the purpose of the JV has been accomplished, it can and should cease to exist. The necessity to provide for the de-allocation of the JV's IP assets, however, remains the same as for the other "event based" exit strategies of merger or acquisition, dissolution or bankruptcy. See *Checklist — Forming Joint Ventures and the Treatment of Intellectual Property Assets.*