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Joint ventures, IP, and the siren song of joint ownership: inputs, outputs and endgame

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The wise advice often passed along in residential real estate to "think about the exit when you buy" applies to joint ventures (JVs) and intellectual property (IP), as well. Like many other aspects of a JV, it is important for prospective co-venturers to think about inputs and outputs with respect to their contemplated JV's IP.

Specifically, what IP will the JV need to utilize, and what IP will the JV likely create? What will be the structure of the JV itself — a contractual strategic alliance between or among the co-venturers, or a JV company with a separate legal identity? And what will happen to the IP when the JV terminates?

At the outset, the co-venturers should determine what pre-existing IP is needed to accomplish the JV's purpose and who owns that IP. They should first determine the purpose of the JV and define it specifically and narrowly in order to set boundaries for the JV parties in terms of where they bind themselves to collaborate and where they may continue to compete. They should then determine the product, process, or service the JV will produce or provide; where it will be developed and/or provided; and who will own the IP that is needed to produce and/or provide it. It is also important to determine the IP in terms of licensing, assignments and other terms. This article is the second of a three-part series discussing the ins and outs of joint ownership of intellectual property in joint ventures.

Strategic alliance or JV company?

Another key issue that will inform the related analysis is the structure of the JV itself. Will the JV be structured as a contractual strategic alliance between or among the co-venturers, or will the co-venturers form a JV company with a separate legal identity? A strategic-alliance approach might be appropriate when the collaboration has a narrow scope and short duration.

Benefits of the strategic-alliance approach include less complex documentation and the relative ease with which the alliance can be unwound. However, the drawbacks of the strategic-alliance approach and lack of separate legal identity for such a JV are numerous and include, among others, the need to identify and manage who will own each of the assets utilized by the JV, complications concerning the co-venturers' positive and negative rights associated with those assets, a lack of separate identity or branding, lack of continuity, unlimited liability, increased operational uncertainty, and increased financial and accounting complexity. In the context of intellectual property, the relative simplicity of the strategic alliance structure vis-à-vis a JV company does not typically simplify IP issues.

JV companies, by contrast, may be appropriate when the collaboration is broader, more complex, or is of a more long-term nature. Despite JV companies' generally more complex documentation — including filings, the need to address governance issues, and administrative matters — JV companies offer many advantages relative to strategic alliances and can be utilized to help compartmentalize certain IP matters as they relate to the JV's business and objectives.

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In the "strategic alliance" context, the co-venturers who own relevant IP should consider entering into a Joint Development Agreement (JDA) or collaboration agreement and either (1) extending licenses or assignments of the applicable IP to the other co-venturers or (2) placing that IP in escrow with an escrow service company (Escrow Agent) pursuant to an escrow agreement, whereunder the Escrow Agent will release to the co-venturers, or permit them to access, the applicable IP for the JV's specifically defined purposes. Escrow arrangements are most commonly used in connection with software licenses, whereby the licensor will place the source code in escrow with the Escrow Agent for the benefit of the licensee.

As with strategic alliances, in the "JV company" context, the co-venturers who own relevant IP will need to determine (1) what IP will be assigned to the JV company and (2) what IP will be licensed to the JV company. Additionally, the co-venturers should address many aspects of the IP use and development in the JV company's governing documentation in a manner similar to a stand-alone JDA. The individual legal personage, and the ability to install agents and management dedicated to the JV, are key benefits of JV companies with respect to intellectual property.

Specifically, this beneficial separation between the co-venturers and the JV itself can be further enhanced, and potential agency conflicts may be averted or mitigated, by, among other things, precisely defining the scope of the co-venturers' cooperation through the JV company's "purpose" section. Once the JV company's purpose is established, co-venturers should consider including a business-opportunities provision that both (A) requires co-venturers to bring to the JV company business opportunities consistent with that purpose and (B) lays out how those opportunities will be addressed.

Assignments of all relevant IP, one or more licenses, or one or more sublicenses can provide the JV with foundational IP.

For example, if the JV company passes on an "in scope" opportunity, may the co-venturer who sourced the opportunity pursue it? Additionally, the JV company's governing documents should also include a covenant not to compete with the JV company in connection with opportunities that are within the scope of the JV company's purpose unless, in certain instances, specific procedures in business-opportunities provisions governing those scenarios are followed.

The co-venturers' choice of JV structure — a strategic alliance vs. a JV company — will influence the range of options available to them regarding treatment of IP. One option, as noted above, is that all parties to the JV jointly own and have an undivided interest in the jointly developed IP, with each party (including the JV itself if a JV company is utilized) having unrestricted use.

A second, similar option is for each party to have joint ownership of the jointly developed IP but with the parties subject to certain restrictive covenants regarding their use of that jointly developed IP. The third and fourth options are available if the JV is structured as a JV company.

The third option is that the jointly developed IP is assigned solely to one co-venturer and then licensed to the JV during the term of the JV company's existence. The fourth option is for the JV company to own the jointly developed IP during the term of the JV company's existence.

Negative documentation

In all instances, it is important for the co-venturers to understand and document not only what is being contributed or licensed but also what is not being contributed or licensed. This negative documentation can help avoid implied licenses by having the parties agree that neither the JV nor any third party or co-venturer may use another person's underlying contributed IP independent of the JV.

Related issues may include the valuation of assigned IP, licenses back to the assignor, consequences of terminating the JV (whether dissolution or by sale), and related pricing issues in connection with such licenses and termination.

Licenses can come in many different forms, the appropriateness of which will depend on the circumstances. Many different licensing issues should be resolved at the outset, but just as Robert Frost observed that "good fences make good neighbors," threshing out terms from the outset of forming a JV can build the foundation for a successful relationship between co-venturers.

For instance: Should the license be exclusive or non-exclusive? Will royalties be payable by the licensee? Will there be "field of use" restrictions? Who will own any improvements? Who will be responsible for enforcement? And what are the circumstances upon which a license is terminable, and what will be the consequences of termination?

Co-venturers should undertake due diligence on all IP to be used in connection with the JV. Verifying ownership or, if a licensee of the applicable IP, verifying the right to utilize it for the benefit of the JV in the manner contemplated is often critical for the success of the JV. Assignments of all relevant IP, one or more licenses, or one or more sublicenses can provide the JV with foundational IP. Among other steps, co-venturers should evaluate whether the applicable IP is subject to encumbrances, determine whether the applicable IP contains exploitable weaknesses or defects, and determine the dominance or impotence of the applicable IP in the relevant market.

If the relevant IP is burdened by any encumbrances, the co-venturers should examine the impact of those encumbrances and if/how they should be addressed. Title encumbrances are often easily addressed unless a person or entity holding the encumbrance is unavailable, defunct, or uncooperative. Encumbrances might include the following, among numerous other possibilities: security interests, pre-existing licenses, maintenance lapses, source code escrows, prior assignments, existing breaches of licenses or other agreements, and open-source code. Open-source issues may require independent development using a "clean room" approach (i.e., no access to the original code).

Co-venturers should determine whether the applicable IP has any inherent weaknesses or defects that could negatively affect the JV's ability to utilize and exploit that IP. These weaknesses and defects typically can often be identified by properly qualified intellectual property counsel. Further, co-venturers should evaluate whether the applicable IP is dominant in relevant markets or, at the other extreme, covers virtually no significant innovations. Lack of dominant IP often means one or more competitors owns the dominant IP such that providing products or services covered by or related to the co-venturers' IP creates substantial infringement concerns.

Patent infringement issues can be very expensive to resolve and may limit or end the JV's sales. Being accused of infringement may cause reputational harm, and defense efforts can divert executives' focus. And being forced to pull products or services off the market can adversely impact customer relationships, reputation, and profitability.

In part 3 of the series, "The pitfalls of joint ownership," the authors cite reasons to avoid joint ownership of intellectual property, ways to avoid certain problems if they do, and how to "unscramble the egg" when the co-venturers decide to exit the venture.

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