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# Strategic alliances and joint ventures in the context of intellectual property issues

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Sept. 29 - 30, 2003

## INTRODUCTION

Profound changes have recently inundated our society and economy. We have experienced the emergence of a new economy that is global and knowledge based during the 1990's. Free trade, e-commerce and the introduction of a European currency are just some of the driving forces of increased globalisation.

Traditional businesses can no longer compete solely in their own geographical location; and must compete on a global basis to stay vibrant. Globalization introduces larger customer bases, larger markets, and larger production requirements, as well as the need to know local customs.

Moreover the emergence of e-commerce and knowledge based industries has fueled the expansion of world markets and the importance of intellectual capital. Intellectual capital or knowledge changes rapidly particularly in the computer hardware and software industries. This intellectual capital is intangible and capable of being defined and protected as intellectual property. This knowledge is constantly being improved upon and expanded which leads to shortened product lives and the need to adapt and change quickly. It was much easier in the previous economies for an organization to vertically integrate required assets and skills within a single organization. Today's firms tend to specialize in particular assets or skills and are more receptive to strategic alliances or joint ventures to accomplish their goals.

## REASONS FOR STRATEGIC ALLIANCES & JOINT VENTURES

**Do It Faster** – The computer hardware and software industries change so rapidly that it may not be feasible for one organization to manufacture all components.

**Open Up New Markets** – The best way to enter former Communist Block markets may be through strategic alliances or joint ventures to tap into local expertise.

**Accelerate Growth Through Synergies** – Software developers can create more software which fuels a greater demand for hardware which fuels the need for more software.

**Create Industry Standards** – While Apple Computers held their technology proprietary IBM licensed clones of its PC compatible technology.

**Overcome Access Restrictions** – May need to use local manufactures and employees to enter cultural markets that are different from your own as well as conform to local regulations and laws.

**Tap Into Lower Cost Structure** – Many software programs are written in India by an educated work force which designs software overnight, and delivers the product the next day by internet.

**Require Financing** – Many start-ups have the technology but do not possess the financial resources to commercialize their technology.

**Open New Product Lines** – Large organizations can introduce new product lines developed by others.

**Share Risks of New Enterprise** – It may be more feasible to share risks.

**Intellectual Property** – The Intellectual Property is owned by another.

**Technical Expertise** – The technical expertise resides elsewhere.

## TYPES OF ALLIANCES

### DEFINITIONS

**Strategic Alliances** may generally be considered as two entities working together to attain some common business goal. Strategic Alliances are often characterized by a form of contractual relationship which prescribes the parties respective common goals, generally on a short term basis, or to accomplish a short term object. The strategic alliance will generally involve only a part of the activities of the alliance partners. Examples of strategic alliances include:

1. Co-op Marketing
2. Joint Research
3. Cross Licensing

"Strategic Alliance" is sometimes interchangeably used with "Joint Venture". There is however a distinction between a strategic alliance and joint venture.

**Joint Ventures** generally include attributes of co-ownership and co-management in a relationship characterized by close interaction and co-operation. Joint venture arrangements and agreements tend to be more formal and detailed than strategic alliances. Reasons to enter into Joint Venture Agreements include the ability to combine strength, expertise, know how, technology and capital of separate parties with a sharing of investment costs and risks.

## TYPES OF LEGAL VEHICLES

**Sole Proprietor** – A sole proprietor is an individual who is the sole owner of the business. Generally speaking all other participants are either employees, contract workers or consultants. All income and losses accrue to the sole proprietor and are taxed personally in the proprietor's hands. Sole Proprietorships are not generally useful vehicles in forming strategic alliances or joint ventures. Many start-ups may start off as sole proprietors and have difficulty attracting venture capital. However if the sole proprietor develops a useful invention, this may attract a joint venture partner.

**Incorporation** – A corporation is a legal entity which exists separate and apart from its owners or shareholders. Advantages to incorporation include:

1. Liability limited to the amount of share capital invested in the corporation
2. One may raise capital through debt or equity participation
3. Perpetual existence
4. Generally viewed as a more attractive vehicle to invest in than a sole proprietor or partnership because of the ability to offer special classes of shares
5. There are generally tax advantages to incorporate

A corporation may be private or public. A public corporation has a variety of reporting requirements prescribed by statute. One may also incorporate federally or provincially.

Corporations are managed by directors elected by shareholders. The federal or provincial governing legislation sets out the constitution of the board of directors, director's duties, liabilities and standards of care.

**Partnership** – A partnership exists where two or more individuals or corporations join together to carry on business with a view of profit. A partnership is not a separate legal entity from its owners and each partner in a general partnership is liable for the acts of the other partners. Accordingly partnerships are not generally used in strategic alliances or joint ventures. Furthermore each partner is considered an owner of the business and profits and losses are taxed as personal income.

Partnerships may be general or limited. Partners in a General Partnership contribute capital and generally actively share in the management of the partnership. Each general partner is liable for all the debts and obligations of the partnership. Limited partners also contribute capital to the partnership and are liable for the debts and obligations of the partnership only to the extent of their capital contribution. Limited Partners must comply with the appropriate Limited Liability Partnership Act.

Most joint ventures are structured to limit the partner's ability to bind the other joint partner. Furthermore the joint venture agreement is usually structured for a single undertaking. Care should be exercised in drafting a joint venture agreement to ensure that the courts do not construe the joint venture agreement as a partnership and attract the obligation and liability of partnership. Generally speaking a joint venture is distinguished from a partnership in the following respects:

1. joint ventures are usually limited to a single undertaking
2. scope of the activities of a joint venture are more limited than in a partnership
3. the participants in a joint venture have more latitude to deal with their interest in their property as their own.

4. the authority to bind a joint venture participant is more limited than in a partnership.

**JOINT VENTURE VEHICLES**

There is no legislation prescribing the organization, administration or management of a joint venture. A joint venture may encompass any form of business association including business associations through incorporations, partnerships, co-ownership agreements, and other contractual agreements which is not conducted under a corporation or partnership.

Since many joint ventures are structured to exploit technology which is defined by intellectual property, license agreements are often used.

## DEFINING RIGHTS

### INTELLECTUAL PROPERTY

Intellectual Property has become an important attribute of the high tech economy. Ideas or advantages can be legally defined and protected as intellectual property which includes:

**Patents:** Any new and useful manufacture, article, process or composition of matter and any improvements relating to same which meets the statutory requirements of novelty and usefulness and which is not obvious to a person skilled in the art. The accelerated pace of research and development has seen the introduction and protection of new life forms, software patents and business methods particularly in the United States. These inventions can also be protected in Canada depending on the wording of the claims defining the scope of protection.

**Trade-marks:** Trade-marks generally relate to words, designs, names or symbols which are used in association with goods or services for the purpose of distinguishing these goods and services from others. Trade-marks can be registered provided they are not confusingly similar to other trade-marks and meet the requirements of the Trade-marks Act of the various jurisdictions.

**Copyright:** Copyright resides in every original literary, artistic, architectural, photographic work that is fixed in a material form. Copyright is automatic from the moment it is created but can be registered to provide valuable rights. Copyright also includes moral rights which generally relate to the right of the author to be associated with the work or any adaptations or changes to same. Copyright has become an important intellectual right particularly in the field of software development and the proliferation of works posted on the internet. Furthermore copyright may also exist in data or data organization.

**Designs:** Industrial designs are original shapes or designs which are applied to or ornament an article. Designs can be protected in Canada as Industrial Designs or Design Patents in the United States.

**Trade Secrets:** Trade secrets can be a valuable right that can be protected by injunction or action for damages provided that the information is in fact secret. It is important to adopt procedures to maintain the secrecy of trade secrets through controlled access to those areas embodying the trade secret and if disclosure must be made that appropriate Confidentiality Agreements be in place.

**Know How:** Know How generally relates to information and procedures which can increase the efficiency of manufacture or production and which may or may not be patentable.

**Integrated Circuit Topographies**

**Plant Breeders Rights**

**Technical Information or Business Information**

## CHOOSING JOINT VENTURE PARTNER

It is critical for one to canvass the market place to choose the appropriate joint venture partner in order to ensure the success of the project. The following factors may be taken into consideration when selecting a joint venture partner:

1. Technical Capabilities
2. Market Experience
3. Reputation
4. Government Relations
5. Financial Strength
6. Similarity of Philosophy

One must approach the formation of a joint venture agreement with a general feeling of trust with the prospective joint venture partner otherwise the venture is unlikely to succeed.

## NEED TO ARTICULATE AND CLARIFY THE GOALS AND CONTRIBUTIONS OF THE JOINT VENTURE

It is vital to the success of the strategic alliance or joint venture that the goals, contributions, expectations and obligations are clearly defined from the start.

**Goals:** The goals of each joint venture partner must be clearly set out. One joint partner may wish to develop a new product line, or enter a new market. An inventor may need financing to commercialize a new development, while an established company may need to add a new product discovered by an inventor. The formation of a clear plan will likely keep negotiation of a formal joint venture agreement on track and will form an important guide for legal drafting.

**Contributions:** Likewise it is important to articulate the contributions of each party at the beginning of the negotiations. Will one party contribute the technology while the other capital? How are the various contributions to be valued? Will there be a requirement for added future contributions? Who will make these? Who owns the technology – the contributor or joint venture? Who owns future developments?

**Key Employees:** Typically one joint venture partner or both will contribute key employees to the project. These employees may receive confidential information that needs to be maintained through appropriately worded confidentiality agreements. Moreover it may also be appropriate to include non-solicitation clause of key employees.

**Time Period:** What are the various time periods that will trigger the contributions or marketing of the products or services of the joint venture entity? It is best to raise these issues early to avoid any misunderstanding in the future. If there are step investments to be made they must be clearly defined and linked to any performance criteria.

**Return:** What are the parties expecting to receive as a return on investment or establishment of the venture. If the technology has been licensed to the joint venture what are the royalty payments? How are they calculated? Will increased profits result from the sale of products using technology from one of the joint partners? Will one of the alliance members purchase product from the other on favourable terms? Will increased profits occur from the sale of components?

**Technology:** It is important to define the technology that will be transferred or licensed to the joint venture entity. Will future improvements be licensed to the joint venture? Can the joint venture partner use improvements to the technology developed by the joint venture entity?

**Control:** Who will have the day to day control of the joint venture entity? It is usual for policy issues and direction of the joint venture to be made by input from both parties at the beginning; otherwise it is possible to have a deadlock. There should be a procedure in place when there is a change in goals. It is not unusual for each joint venture partner to have a representative on the day to day management of the alliance. The appropriate quorum should be defined for decisions to be made by the joint venture.

**Expectations:** The expectations of the joint venture must be defined as this will have an impact on the termination provisions of the Joint Venture Agreement.

**Confidential Information** One party may contribute confidential information to the joint venture. Typically the confidential information will need to be disclosed as the parties are in the process of deciding if they should create a joint venture.

## COMMERCIALIZING IDEAS

Joint Ventures are particularly useful vehicles for start-up operations. Start-up operations are typically characterized by an inventor who has made a discovery which may have been patented and developed as a prototype or even sold in limited quantities. However the inventor may not have the financial resources to commercialize the development on a large scale. Furthermore an effective distribution network is typically lacking. The inventor may have difficulty attracting traditional financing from banks or other financial institutions. Traditional financing sources may not understand the technology, nor do they know how to value the technology that is not proven. Generally it may be difficult for a start-up to use intellectual property as collateral. Furthermore there is no track record for the banks to lend money.

A joint venture on the other hand differs from traditional financing. A joint venture creates a more integrated approach than a traditional lending transaction. The joint venture in this case includes one party that infuses cash to the venture while the other party supplies the technology. While a bank is generally primarily interested in a rate of return, the financial joint venture partner will have an on going relationship with the technical partner as they have a common economic interest to the success of the venture. The financial joint venture partner will share in the fortunes and set backs in the venture. The joint venture turns the creditor into an investor. The financer in the joint venture will have an increased commitment to the overall success of the venture.

If future financial infusions are required it is important to canvass this issue and to define any maximum contributions and time periods for the contribution. Reinvestment covenants can be included in the joint venture agreement for the technical person to reinvest a portion of their own return back into the joint venture to increase the commitment of the technical person in the project.

The governance of the technology will tend to reside with the technical person while governance issues dealing with finance will reside with the financial joint venture partner. Increased governance by the financial investor gives greater control over the investment.

Research and development can also be financed in a similar fashion.

A joint venture arrangement may also be used where a number of parties are working on the same technology and they wish to spread the risk over a number of parties. In this case each participant shares in the rewards of success and plays a part in contributing to the technical development and day to day operation of the venture.

## QUANTIFYING CONTRIBUTIONS

It is easy to quantify financial contributions. However the value of technology, ideas, or intellectual property is generally more difficult to quantify. Many of the accounting firms have intellectual property valuators that perform these functions; but ultimately the intellectual property is worth what someone is willing to pay for or invest in.

The value of the intellectual property may be lost or diminished if the rights are not timely filed or maintained. For example:

**Patents:** Canada will grant a patent to the first inventor that files a patent application. Moreover an inventor must file a patent application in Canada and the United States within one year of public disclosure, otherwise the issued patent can be invalidated. Most other countries around the world require absolute novelty at the time of filing. In other words the patent must not have been disclosed to the public anywhere in the world before it was filed for in that jurisdiction. Furthermore maintenance fees must be paid to keep the patent in force. Moreover an assignment of a patent may be void against a subsequent purchaser who did not have notice of the previous assignment.

**Trade-marks:** Although trade marks may be protected in Canada if they are not registered, it is generally advisable to do so as it is easier to protect a registered trade-mark. Registered trade-marks must be renewed to keep them enforceable. Furthermore the trade-mark must be used otherwise they can be expunged. Finally it is important for the owner of the trade-mark to control the quality of the goods or services marked by the trade-mark as well as the mark itself otherwise the trade-mark can be invalidated.

**Copyright:** The owner of a US copyright may loose the right to damages if the infringer can demonstrate they did not have notice of the copyright. The infringer is deemed to have notice of a registered copyright.

**Design:** An industrial design registration may be invalidated if it is not filed within one year of public disclosure. Moreover the design must be marked in Canada in order to be entitled to an award of damages.

**Trade Secrets:** The value of a trade secret may evaporate if the owner of the trade secret does not take steps to maintain the secrecy of the information.

Due diligence in maintaining registration of the respective intellectual property rights will at least maintain or increase the value of the contributions of the various parties.

Sometimes the parties who are contributing specific assets may find that their contributions are valued at less than their perceived share in the joint venture. For example parties may end up with a 50/50 split despite unequal contributions. The joint venture entity may also need additional technology in order to accomplish its goals. This may take the form of additional contributions by the joint venture partner to improvements developed by the joint venture partner outside the joint venture. Therefore it is important to distinguish between technology that is developed by the partner and technology that is acquired and paid for.

There may also be emergency financing obligations, to be injected in a timely fashion, after a notice period. Emergency financing obligations should be coupled with the method of deciding who will determine when an emergency situation arises and the maximum advance should be specified ahead of time.

## CONFIDENTIALITY AGREEMENTS

Confidentiality Agreements are typically used at the commencement of negotiations to formalize the exchange of information, property and technical and business information. The final Joint Venture Agreement will also have confidentiality provisions.

This agreement will generally provide that one party is disclosing information to another that is confidential for the purpose of evaluating same in order to determine whether the parties will enter into an agreement to exploit the subject matter of the confidential information. The agreement will carefully describe the subject matter of the confidential information and provide that the information and all copies of same will be returned if the parties decide not to proceed with the venture. The Confidentiality Agreement will also provide that the information must not be used without the prior written consent of the owner.

These agreements normally exempt the following from the obligation of confidentiality:

1. information that is known or part of the public domain

2. information previously acquired

3. information acquired from a third party entitled to disclose such information

4. information ordered to disclose by a court of competent jurisdiction

If there is mutual disclosure of confidential information both parties may be bound by the same provisions in the agreement.

Frequently the Confidential Disclosure Agreement will include an indemnity clause requiring the disclosee to indemnify the discloser against all damage and loss from breach of the non-disclosure provisions including the payment of the discloser's attorney fees.

The Confidential Disclosure Agreement may also have non-compete provisions which should be reasonably drafted in terms of subject matter, duration, and geographical location.

Finally the Confidential Disclosure Agreement may have provisions which prohibit the disclosee from soliciting the employment of the disclosers employees.

## DUE DILIGENCE

After the parties have agreed on the basis of the Joint Venture a period of time is generally provided for to conduct a detailed review of all information that is relevant to the proposed business venture prior to the execution of the Joint Venture Agreement. If the technology drives the transaction some of the issues that need to be canvassed and verified include the following:

1. Has the contributing party protected its intellectual property?
2. Has the contributing party maintained its patents trade-marks and designs?
3. Does the contributing party have the appropriate license to use third parties technologies and the right to sublicense them to the joint venture.
4. Assess the validity of all patents, trade-marks, copyright, and designs.
5. Assess the scope of all patents, trade-marks, copyright, and designs.
6. Do third parties have rights to the intellectual property in the contributed property?
7. Is there any litigation relating to the contributed intellectual property?
8. Are there any agreements that would prevent exploiting the intellectual property contributed to the joint venture?
9. Are other forms of intellectual property required?
10. Are domain names protected?
11. Conduct trade-mark, trade name, common law and domain name searches to verify the validity and scope of protecting valuable trade-marks.

12. Are trade-marks validly licensed to third parties?

13. If the joint venture is established for an e-commerce venture have patent applications been filed for or issued for business method patents?

14. It is not uncommon for software developers to inadvertently use layouts, graphics, or photographs created by third parties and if so these should be checked and the appropriate consent obtained.

15. Obtain assignments of all software developments undertaken by the joint venture participants.

16. Ensure that data residing in computer systems is secure and a back-up in place.

17. If the web site is hosted by others ensure security and privacy of the data.

The results of the due diligence exercise will affect the substance of the representations and warranties included in the Joint Venture Agreement as well as the indemnities provided for in the agreement.

## LICENSE PROVISIONS

A contributor to a joint venture may either transfer title to the intellectual property to the joint venture by assignment or retain ownership without giving up title by licensing its rights and even retaining the right to use the intellectual property in the continued operation of its own business.

A license is different from an assignment, in that an assignment relates to the transfer of legal title in the property, while a license permits someone to do something which they could not otherwise legally do. Patents, trade-marks, copyright, designs, trade secrets know how and other intellectual property can be licensed. Accordingly a license is a valuable tool in the context of defining joint venture arrangements. It is a contract which defines the rights of the parties.

A license creates a personal obligation. It does not create an interest in the subject matter licensed. The licensor does not grant the licensee a property interest in the intellectual property being licensed. Since no property right is transferred, the license does not give a licensee a right that can be transferred. If a licensee requires the right to assign its rights under the license (ie sub license) a specific term must be provided for in the contract.

Generally speaking a license agreement should specifically deal with particular terms or conditions as they will not generally be implied if the agreement is silent. For example there is no implied term that:

1. a patent is valid
2. a license to manufacture under a patent includes the right to use
3. a patentee will sue infringers.

Therefore it is prudent to specifically provide for those terms and conditions that are important to the licensor and licensee in the joint venture.

We shall now review some of the typical terms and conditions found in a license agreement.

**PARTIES**

Obviously, the parties, namely the contributors to the joint venture ie the licensor and licensee must be identified.

If the joint venture entity requires the right to sublicense third parties to use the intellectual property such right must be specifically provided for in the agreement.

**RECITALS**

The recital is that part of the agreement which occurs after the identity of the parties, but before the operative terms of the license agreement. The recital generally recites the intention of the parties and may become important in the event one of the parties desires to imply a term into the contract which has not specifically been dealt with in the agreement.

## GRANT OF LICENSE

Although there are an infinite number of ways in which a licensor may grant the licensee the right to use the Intellectual Property the following are the most common:

**Non-exclusive License**: A non-exclusive license is a license which has been granted by the licensor and enables the licensor to give as many and different permissions to use the intellectual property as the licensor chooses. For example a patentee may grant several different licensees namely the right to make, use, or sell a patented invention in a defined territory for a defined period.

**Sole License:** A sole license gives the licensee the right to exercise the intellectual property against all persons except the owner of the intellectual property.

**Exclusive License:** An exclusive licensee gives a licensee the right to exercise the intellectual property rights against all persons including the licensor. For example a patentee may grant one licensee the exclusive right to manufacture and grant another licensee the exclusive right to use or sell the manufactured article. Furthermore the exclusive right may be limited to a defined territory such as the province of Ontario. Moreover the period of exclusivity may be limited to a period of time.

Exclusive licenses are usually required to be registered in the Patent Office; otherwise a subsequent licensee without notice of the previous licenses may obtain superior rights.

Exclusive licenses may be granted when the licensee must make a substantial financial investment in order to work the invention, and needs the exclusivity to obtain commercial success in the venture.

It is normal for the licensee, in an exclusive license agreement, to make sure that the licensee performs by:

1. including minimum royalty provisions
2. including a mechanism to terminate the exclusive license if certain goals have not been met, or
3. including a right to change the exclusive license to a non-exclusive license in the event that the licensee does not perform as expected.

Therefore if the licensee does not perform, the licensee has the option of paying the minimum royalty or allowing the license to lapse. It would be in the best interest of the joint venture to require that the minimum royalty be some nominal amount at the beginning of the license term and that such minimum royalty would increase yearly to account for the early start up costs of the venture.

**<u>SCOPE OF LICENSE:</u>** When dealing with patents it is important to define those rights which the patentee desires to license to others. This definition will have an impact on the other provisions of the license agreement such as royalties, improvements, termination rights, indemnification, warranties and representations.

Licenses may be termed as "general" or "limited" depending on whether the licensor imposes a restriction on the patent rights licensed. The patentee may "generally" license all of its exclusionary rights namely the right to manufacture, use, sell, or import into Canada

However, the patentee may "limit" the license by only granting some of these rights. For example, a patentee may license one person to make and sell the invention as claimed, but not the right to use it; while another person may obtain the license to use the invention with no right to make or sell it. Furthermore, if the patented invention may be used in different fields, the licensor may wish to restrict the licensee's use to a particular field.

An important aspect concerning limiting the scope of the licensee's right to use the technology, is that such limitation should not be construed as a restraint of trade. Restraint of trade issues including anticombine or antitrust laws must be considered where the invention is licensed to be practised in the United States or other foreign jurisdiction. It is prudent to retain counsel in the different jurisdictions which are effected by the license agreement.

The Competition Act in Canada defines restrictive trade practises and includes prohibitions against exclusive dealing, market restrictions, tied selling, and price maintenance.

**<u>TERRITORY:</u>** The patentee may restrict the scope of the license to be practised within a particular territory. Territorial restrictions are common in international licenses where a patentee may have patents in several jurisdictions and license the use in specific countries. Thus a patentee may grant one the exclusive right to manufacture a product in one country and grant another licensee a non-exclusive right to sell same in a different country.

A question may arise under such international license as to whether or not the patentee may impose restrictions which limit the right of the licensee to export into different countries. Such provisions should be reviewed to ensure that they do not offend the Competition provisions of the respective countries.

**<u>TERM:</u>** The license may be granted for the full term of the patent or for a lesser term. Factors which affect the term of the license include:

1. the financial investment of the licensee
2. if the license is exclusive or non exclusive
3. the life expectancy of the patented article

Furthermore the parties could agree that the term of the license is for a period of 5 years and automatically renewable for successive one year periods of time unless one party provides the other with 90 days written notice of its desire to terminate the license.

**IMPROVEMENTS:** The issue of improvements relating to the Intellectual Property is extremely important in the context of the Joint Venture Agreement. If the agreement is silent on this point no improvements will pass.

Since either the technical contributor or the joint venture could develop improvements relating to the technology, it is quite normal to include these terms in the license agreement and deal with:

1. Prompt disclosure of the improvements to the other party
2. Provide for the ownership rights to the improvement
3. Who will obtain the appropriate Intellectual Property protection?
4. What obligations arise between the licensor and licensee in connection with the improvements?
5. How are improvements defined?

These issues become important when one party does not wish to disclose to the other information relating to information it has developed. It is common to exclude the disclosure and use of information relating to improvements jointly developed by the licensor or licensee with third parties.

A grant of rights to improvements by the licensor to the licensee is called a "grant-forward" while a grant of rights to improvements by the licensee to the licensor is called a "grant-back".

A "grant-forward" usually includes the requirement that the licensor disclose improvements to the licensee and license their use. The "grant-forward" may include improvements that the licensor makes or acquires.

A "grant-back" usually includes the requirement that the licensee disclose improvements to the licensor and license their use. These provisions are important to the licensor as it prevents the licensor's technology from becoming obsolete. However some "grant-backs" may be considered as a violation of antitrust laws if they perpetuate a dominant position in the market place. Furthermore a joint venture requiring a "grant-back" provision should have employment agreements with employee's of the joint venture to assign their rights to the inventions to the joint venture.

The improvement clause should also cover the duration of transfer of the rights to the improvement and whether the transfer survives the original license, and if so, whether there is any adjustment to, or extension for royalties.

Moreover the improvement clause should address the issue as to whether the rights to the improvement is limited to the scope of the originally licensed patent or to the entire field of the originally licensed patent.

## ROYALTY

The parties normally take great care to define the basis of the royalty payments, and may include one or more of the following:

**Lump Sum:** Lump sum payments offer a simple method for payment of the right to use the intellectual property. A lump sum payment may be made for the whole term of the patent, or alternatively annually.

**Percentage of Profits:** The payment of royalties is generally based on the extent of use of the licensed rights. In some cases royalties are paid on a percentage of the licensee's profits, and if so it is critical that profits be defined. It is generally not advisable to base royalties on "profits" since profits can vary or be adjusted in accordance with generally accepted accounting principles.

**Fixed Sum Per Unit:** Royalties based on a fixed sum per unit presents a relatively simple way to calculate royalties. This method, however, does not take into account inflationary pressures during the term of the patent. It is normal in these cases to include a cost of living increase.

**Percentage of Selling Price:** The most common form of royalty payment is based on a percentage of the selling price of the product or service. The actual percentage is a matter of negotiation between the parties, and will depend on:

1. the importance of the patent
2. whether the scope of the patented claims are wide or narrow
3. the financial contributions required by the licensee to work the invention

It is important to specifically define the "selling price." Discounts, taxes and refunds are normally excluded from the selling price of the product.

The parties may negotiate the payment of a royalty based on the combination of a lump sum and a percentage of the selling price of the product. Alternatively, the parties include a relatively low royalty payment during the first part of the term of the license contract to take into account the start-up time and costs of the licensee, with a higher royalty rate during the later part of the license agreement.

Moreover great care should be given to defining the product or process which shall attract the royalty rate. Initially the licensee will manufacture the product or use the process as claimed in a patent. However, over time, the licensee may modify or improve the manufactured process or product such that it may no longer fall within the claims of the patented invention. Questions may then arise as to whether or not the improvement or developed product attracts a royalty.

**Minimum Royalties:** A licensor will consider whether it is appropriate to add the requirement of a minimum royalty particularly when an exclusive license is granted to the licensee. This will protect the licensor in the event that the licensee is less than enthusiastic in working the patented invention.

**Payment Provisions:** The parties will also decide on the frequency of the payment of the royalties on a quarterly, semi-annual, or annual basis.

**Accounting Records:** The licensor will frequently require the licensee to provide a summary of information necessary to calculate the royalty as well as back up documentation. Moreover, the licensor usually requires a right to inspect the licensee's records as well as obtaining an independent certificate from an accounting firm certifying the accuracy of the information provided to the licensor by the licensee. If the licensor actively partakes in the day to day management of the joint venture it may not be important to include such provisions in the agreement.

## INFRINGEMENT OF PATENTS BY THIRD PARTIES

Unless the license agreement otherwise provides, there is no implied warranty that the patentee will sue an unlicensed infringer. Normally both the licensor and licensee will have an interest in prosecuting unauthorised infringers since the licensee's sales will likely drop and the royalties received by the licensor will be correspondingly diminished. Usually the license agreement provides a provision whereby the licensor has the first right to launch a patent infringement action. In the event that the patentee fails to launch a patent infringement action, the licensee may require the right to decide to take carriage of the court proceeding.

## SUITS BY THIRD PARTIES

Unless a license agreement otherwise provides, there is no implied warranty that a licensee will not infringe the rights of third parties when using the patented invention pursuant to the license agreement.

## PRODUCT LIABILITY CLAIMS

A licensee may also be interested in including terms in a license agreement dealing with product liability claims. Such product liability claims may arise as a result of damage suffered by the purchaser of a product made and sold by the licensee in accordance with a licensed patent.

## TERMINATION RIGHTS

The parties will negotiate which events will result in the termination of the license agreement and include the following:

1. the natural expiration of the term of the agreement
2. the bankruptcy or receivership of one of the parties. It should be noted that it is possible that a trustee in bankruptcy or receiver may dispute the enforceability of such clauses.
3. Material breach of the agreement such as payment of royalty fees, invalidity of the patent, failure to prevent unlicensed competition.
4. The parties may provide termination after reasonable notice period of breach of the agreement and failure to rectify such breach.

## EFFECT OF TERMINATION

A licensee will generally lose all rights under the license upon termination thereof. The license agreement may include a provision that all rights and remedies of a licensor will survive the termination of the agreement. Therefore the licensee may wish to include a provision which permits the licensee to either:

1. sell the remaining inventory of products manufactured in accordance with a licensed patent for a specific time period; or
2. fulfil any outstanding contracts within a particular time period after the termination of the license agreement.

## CONFIDENTIALITY

Patent license agreements may include a covenant by the licensee to keep any technical information or trade secrets confidential, particularly when such technical know how has been transferred along with the patent license agreement. The period of confidentiality may continue for a fixed period after the termination of the license agreement or until the information becomes part of the public domain.

## NON-COMPETITION

The parties may also consider whether or not it is appropriate to include a non-competition clause in the license agreement. Generally speaking the licensee will resist the imposition of a clause not to compete within a certain defined period and particularly when a licensee has previously been carrying on business in the same field. The licensor may have a better opportunity of including a non-competition clause in the event that confidential technical information and know how has been transferred along with the patent license. One should be careful, however, when attempting to include such clauses in foreign patent license agreements.

## ARBITRATION

Arbitration may be a useful method of resolving disputes that arise from the license agreement.

## JURISDICTION

If the parties are negotiating an international license agreement, it is appropriate for the parties to decide what jurisdictional laws are to be used in the interpretation of the contract as well as which courts will have jurisdiction to decide any illegal issues. Many countries have restraint of trade statutes and patent laws quite different from Canada. A provision that may be enforceable in Canada may be found unenforceable in a foreign jurisdiction.

## MAINTENANCE OF INTELLECTUAL PROPERTY

The license agreement should spell out which party is obliged to maintain and pay for the maintenance of the various types of intellectual property.

## REGISTRATION AND NOTICE PROVISIONS

Some jurisdictions require registration of all intellectual property agreements with penalties ranging from fines to invalidation of the intellectual property.

## OTHER ISSUES

The joint venture transaction will likely include many of the provisions described above in connection with license agreements. Other provisions include some or all of the following:

**Representations and Warranties:** A joint venture will require representations and warranties regarding the technology being licensed from the joint venture partner. These representations may include:

1. all material information regarding the technology rights have been fully disclosed to the joint venture;
2. the licensor has the right to use the technology, and the right and ability to license the joint venture to use the technology;
3. a representation that the licensor owns the technology free and clear of any encumbrances or rights held by third parties;
4. all foreign and domestic patents, copyrights and trademarks being licensed are valid and in full force and effect and are not subject to maintenance fees or taxes;
5. a representation that the licensor will maintain the patents, copyrights and trademarks being licensed;
6. a representation that the licensor will continue to preserve the confidentiality of trade secrets;
7. the licensor provides the rights necessary for the joint venture to carry on its business as planned;
8. a representation that the use of the licensed property will not conflict with, infringe upon or violate any proprietary right of any other person;
9. there are no pending or threatened adverse claims concerning any of the technology being licensed

10. all necessary governmental procedures relating to the transfer of the technology have been completed.

The licensor may also require certain representations and warranties from the licensee such as a representation that the licensee will render all necessary assistance and co-operation in obtaining required work permits or immigration clearance for visiting employees.

**TECHNICAL ASSISTANCE**

In order to ensure the success of the joint venture there may be a provision for on going assistance for a specific time period. Generally such technical assistance is based on compensation on a per diem rate which may be adjusted to take into account inflation or cost of living index.

**TRADEMARK ISSUES**

During the joint venture, the joint venture partners may jointly own the trademark. Upon termination it is generally not practical to jointly own a trademark.

In forming a joint venture, the joint venture partners will often select trademarks or trade names that identify the joint venture partners. Upon termination of a joint venture, the former joint venture partner may not want to permit the continued use of the joint venture trademark and trade name because it may falsely suggest that there is a connection between the joint venture and the joint venture partner. Furthermore continued use may dilute the distinctiveness of the trademark and render it invalid.

Moreover a withdrawing joint partner may find it very difficult to reclaim a trademark that was used by the joint venture. Accordingly the trademark license agreement should expressly provide that the licensee will cease use of the trademark upon termination and will not use a confusingly similar name.

## FOREIGN TRADE RIGHTS

It may be necessary to obtain permission from the host country to engage in foreign trading activities. Furthermore there may also be import and export restrictions imposed by the foreign jurisdiction. These requirements should be investigated and addressed in the agreement.

## FOREIGN CURRENCY RULES

Some jurisdictions require permits to establish licenses to transfer currency out of a particular country. The method of calculating the rate of exchange to determine the appropriate payments in the currency of the licensor's country should be included in the license agreement as well as specifying how the currency conversions are to be made.

## GOVERNANCE

The rules of governance of the joint venture should be determined during the negotiation stage. The various parties will put in place a structure which reflects the degree to which each participant wishes to continue to be involved in the management of the strategic alliance or joint venture. The agreement will specify the parties respective rights to elect or appoint members of the management team, determine which decisions are only to be made by such members or by senior management of the respective parties. Major policy issues relating to control should be addressed by both parties. Furthermore there should be a workable arrangement of the day to day control of the alliance or joint venture.

A shareholder's agreement should be considered to address board representation and vc ;. Other considerations include:

1. a requirement that representatives of each party to the joint venture be required to sign contracts and cheques;
2. a requirement requiring the consent of the other party when entering into material contracts, termination of the joint venture, sale, transfer, sale of a material portion of the joint venture or the need to provide guarantees.

Moreover the day to day operations may be managed either by an independent management team, a team selected from each of the parties to the joint venture, or the management functions may be split between the parties in connection with different functions of the joint venture.

**SOURCE CODE**

The joint venture will likely utilize computer systems and software in carrying out its obligations. Furthermore it may be necessary for the joint venture to have third parties customise or design their computer systems. It is important in these circumstances to attempt to obtain intellectual property ownership to the developed systems or software from third party software developers. If it is not possible to obtain a transfer of ownership to the rights of the computer system, it may be appropriate to enter into an escrow agreement with the third party software developer whereby the source code (which comprises the human readable code for the software) be placed in escrow with an escrow agent. Furthermore it may be appropriate to canvass these issues if one of the joint venture partners is contributing a computer system or software.

Moreover if a joint venture partner requires return of any developed software upon termination of the agreement it is appropriate to enter into agreements with employees of the joint venture or independent third party contractor to have the rights assigned to the joint venture partner.

**DOMAIN NAMES**

The joint venture should consider the issue of registering important domain names as well as well as what will happen to the domain names upon termination of the joint venture.

**CONCLUSIONS**

This paper has touched on some of the pertinent issues relating to strategic alliance and joint venture agreements.

It is anticipated that the strategic alliance and joint venture will play an increasing role in technology transfer agreements particularly in view of the continued developments in the computer, biologic and robotic engineering fields.