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STRATEGIC PLANNING FOR STRATEGIC ALLIANCES: AN INTELLECTUAL PROPERTY PERSPECTIVE

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Strategic Planning for Strategic Alliances: An Intellectual Property Perspective

by Victoria A. Cundiff*

One of the most common reasons for establishing a joint venture or other strategic alliance is to gain the benefits of intellectual property or technology without having to bear the full cost of developing it. Sometimes prospective alliance partners each can contribute existing technology. Sometimes they each have critical know how or patents for developing new technology. Sometimes they expect they can work together to develop new intellectual property.

But finding a good "technological" fit is only the starting point for successful strategic alliance negotiation. Combining technologies, or working together to create new ones, can create a minefield of business and legal difficulties. While not all possible issues need, or even can, be resolved in initial discussions, the canny businessperson should be aware of some of the potential pitfalls. Many can be prevented by frank discussion and due diligence early on; others can be addressed in contractual provisions; and still others can expressly be left open for resolution in the future once the technology and business have evolved. This article flags some common issues and explores a variety of ways of solving them.

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Laying the Groundwork: Confidentiality and Disclosure

One of the first steps in lining up a potential technology partner (the term is used here regardless of the business form of the project) is to investigate the technology. For the party that owns the technology, the process most likely will involve disclosing information that has previously been held in confidence. While under certain circumstances courts are prepared to infer a duty on the part of the party investigating the technology to hold it in confidence, see, e.g. Phillips v. Frey, 20 F.3d 623 (5th Cir. 1994), why leave the scope of that duty up to the cost and uncertainty of litigation? A more certain approach is to enter into a confidentiality agreement in which the party receiving the disclosure agrees to use the information solely for purposes of evaluating whether or not to proceed with the venture and to return all documents containing confidential information if the venture does not proceed within a specified time . In certain situations, it may make sense to agree in advance on who, by name, will see the technology. In most circumstances, it will make sense for the receiving party to agree to retain a list, with each recipient affirmatively agreeing to the confidentiality restrictions.

A caution to the party investigating the technology: while it may be sensible to explore a number of different partners and technologies, don't let the exploration process spread Company A's technology to Company B to Company C, either directly, such as by showing one company's schematics to another, or indirectly, by posing questions like "Have you ever considered sourcing your raw materials from custom supply house x?" To prevent such leakage, it may be best, if practical, to have different people interacting in depth with each technological candidate and report their non-proprietary conclusions to the decision makers. Finally, to avoid misuse of secrets learned during the due diligence phase, if the transaction does not proceed, it is sensible not to have the employees who were given access to confidential

technology be the same people who later develop similar technology. Cf. Celeritas Technologies, Ltd. v. Rockwell Int'l Corp., 150 F.3d 1354 (Fed. Cir. 1998), cert. den., Rockwell Int'l Corp. v. Celeritas Technologies, Ltd. 525 U.S. 1106, 119 S. Ct. 874 (1999).

Strategic Thinking – and Rethinking

While exploring the technology, a business will want to consider both the quality and availability of the technology and its own overall business objectives. "Forming a strategic alliance" is rarely a complete business objective. Rather, the business objective may be to acquire an assured supply of a patented chemical ingredient. Perhaps a supply agreement would solve that problem with far less commitment, and uncertainty, than is involved in acquiring a license to manufacture the product or in forming a joint venture.

Formulation of the business objectives, of course, will evolve with examination of the technology. If the goal is to acquire rights to use particular technology, is a continuing relationship necessary (as it could be in a fast changing industry) or undesirable (as it might be if the technology developer is on the brink of bankruptcy)? If a continuing relationship is desirable to acquire future improvements to the technology, is there any assurance that improvements will actually be developed? Can such assurances be negotiated?

If acquiring a right to use technology is an objective, does the grant really need to be exclusive? Almost certainly so if the license covers a critical component in an industry where the licensee lags behind. Perhaps not if it covers only one component in a product for which the licensee has developed overall superiorities to the closest competitor. Does the grant need to be worldwide? If the technology is necessary only to run a single domestic plant, perhaps not. Or is the competition for customers expected to be

worldwide -- now, or after the Internet advertising begins? If so, perhaps the parties should negotiate an option to acquire worldwide rights, or a phase in of royalties -- unless the technology is not competitively advantageous in other parts of the world.

These and many similar issues should be thought through and continuously checked and rechecked throughout the initial consideration, due diligence, analysis and negotiation stages. Answering such issues early on can help point the way to the topics to be addressed in the agreements, and can help determine what type of business arrangement makes the most sense -- e.g., a license agreement, a supply agreement, a development agreement (joint or otherwise), a joint venture, a merger, or a technology purchase.

Due Diligence

The party considering the technology will want to conduct due diligence from both a practical standpoint -- is this likely to become obsolete during the term of the alliance? -- and a legal standpoint. Critical issues will include:

- What technology is involved? Sometimes parties focus on hardware or nuts and bolts issues and forget that computer software or special ingredients are also essential.

- Who owns the technology?

- Does the same person or entity own all elements of the technology?

- If some portion of the technology is owned by a third party but licensed to one of the prospective alliance partners, does the license cover the intended use? will the third party have to approve a sublicense to the

alliance entity for the intended use? (if it is unclear, it may be prudent to ask the third party early on)

- Will the third party grant a direct license to the alliance? If not, perhaps some other form of venturing may be appropriate. What expenses will be associated with the direct grant? Who will pay them?

- How important is the technology to the overall venture? If it is mission critical, perhaps it should be acquired outright.

- What royalties or fees will the technology owner charge? What other forms of "compensation" will the technology owner expect to get? If the technology is owned by one of the joint venture partners, will/can the grant of technology be part of that party's capital contribution to the joint venture?

- Is the technology patented? Where? What is the remaining life of the patent? Has the patent been challenged?

- How dense is the field? What is the scope of the patent protection? Are other patents necessary to practice the technology? These issues may point to the value to be placed on the technology.

- What sort of indemnification will the technology owner -- third party or alliance partner -- offer to the alliance and its partners? From a products liability and/or environmental standpoint? From an infringement standpoint? For legal fees?

- Has the technology been licensed to others? Where? For what purpose? Would any existing licenses thwart the plans of the joint venture?

- Is the technology owner prepared to grant the joint venture an exclusive license to the technology? If not, what impact does this have on the joint venture's plans?

- Does the venture need exclusive rights?

- If the technology is protectible as a trade secret, has it in fact been held in confidence? Are adequate safeguards in place to keep it secret? Are those who developed the secret bound by confidentiality or non-compete agreements? Has the party contributing the technology incorporated trade secrets of others?

- Does anyone hold a security interest in the technology or equipment or facilities necessary to practice it?

- Are there local restrictions on transferring the technology at issue?

While it may not be necessary to resolve all of these issues at the outset, any significant risk factors should be noted for resolution -- perhaps primarily via a price adjustment -- at some later point.

Drafting Agreements

Often exploration of strategic technology alliances will involve a series of phases after the initial diligence as the parties agree on the extent of their intended commitment to share technology. Those phases are typically described in a series of memoranda describing business points that the parties then reduce to formal agreements.

Too many companies involved in acquiring or transferring rights to technology reach for their "form files" far too early in the process. This approach means that they apply other people's strategies to a new alliance. Someone

else's strategic thinking may lead to disaster. While "forms" may service as a useful checklist, they cannot substitute for creative thinking about the business strategies this alliance is intended to serve. To take one example, consider technology representations and warranties. At least representations and warranties can be copied from the form file, right? Yes, if they are used as a checklist. No, if they are to be used as boilerplate. For example, if certain of the licensed or transferred technology is mission critical, it may make sense to require separate representations, warranties, indemnifications, and perhaps escrow agreements for that technology. It might make sense to specify that a failure of these representations and warranties is grounds for rescission.

In other cases, especially where the technology is to be replaced with new technology down the road, or where competitive intellectual property is developing very rapidly, it may make sense to put an expiration date on the representations and warranties. The key point to remember is that the representations and warranties, like all other contractual provisions, should be tailored to the overall business strategy.

Getting Started: The Development Phase

Often it is not clear at the outset that the parties need a long term relationship. The life cycle of many joint ventures or other strategic alliances includes an initial development stage where the parties evaluate how to use or combine their technologies for the intended purpose and devote substantial effort, either separately, or as part of a joint development team, to trying to do so. Sometimes these efforts don't succeed. Cost-effective technology simply can't be developed. Or the demand for the finished product drops. Or for some other reason, the project never gets beyond the development phase. Careful planners try to agree up front what will happen to the technology if the proposed venture does not proceed beyond this phase.

In most cases, they will decide without much discussion that the technology each party contributed will go back to that party, with the other party retaining no rights in it. But what about the technology developed by (or for) the joint venture? Perhaps it works well for the intended purpose, but the venture no longer has an interest in pursuing that purpose. Or perhaps the venture-developed technology has value for a totally different purpose. In either case, perhaps the joint venture technology is so intertwined with the technology contributed by one of the venturers that as a practical matter it cannot be disentangled.

Parties focusing on these issues at the outset might arrive at a number of business solutions such as:

- if one party clearly contributed more of the core technology, that party gets to keep and exploit all developments;

  or,

- if the contributions are more nearly equal, each party keeps what it contributed and neither party may use the jointly developed technology without paying a royalty (perhaps to be negotiated within specified parameters) to the other;

  or, as a refinement to this approach,

- none of the joint venturers may use the jointly developed technology for the purposes set forth in the joint venture agreement without paying a royalty, but any party may use the jointly developed technology royalty-free for other purposes; to the extent the joint technology embodies technology contributed by another party that party shall grant a license to use the technology for the alternate purpose at specified rates

(or at rates to be negotiated within certain parameters); and

- neither party shall impair the value of the property to the other (such as by disclosing trade secrets);

or,

- preserving the widest variety of options, the parties can agree to jointly review any jointly developed technology and documents at the dissolution of the venture and jointly determine who gets to use what for what purposes; in the event of disagreement, all disputed documents will be held in confidence and neither party may use the disputed jointly developed technology until further agreement, mediation, or an arbitrator or a court resolves the issue;

or,

- finally, the parties may arrive at a variety of other options tailored to the specific transaction and relationship among the parties.

These different approaches of course require, and result in, different levels of certainty at the outset of the proceeding.

It may not be possible to arrive in the early drafting stage at a detailed solution to an as yet ill-defined problem. Including a provision requiring any impasses on who gets what at what price to be submitted to a mediator or arbitrator, identifying a specific neutral to fill that role, and perhaps specifying guidelines for resolving likely issues, can be ways to help the parties salvage any usable technology without confusion or strife. Not contemplating these potential, and very common issues, early on, however, diminishes the

chances that the transition will be smooth if the joint venture does not proceed.

Parties in the development phase should also be mindful that during that phase the other alliance partners, and perhaps even third parties, may be given access to technology they do not own. Common sense dictates that entry into a confidentiality agreement should be made a condition of access. This agreement will typically be more detailed than the initial confidentiality agreement, but generally should be drafted to continue to protect even the initial disclosures. It may also be sensible as a practical business matter to limit the number of people who are exposed to the proprietary technology during this phase so that if the venture fails, fewer technical people will be "tainted" by another's technology in the future.

Up and Running

Often, of course, the development phase ends in success: the technology is promising and the project proceeds. At this point, the parties usually enter into a new, more detailed technology agreement. Thoughtful drafting is still necessary to prevent later disputes over what rights the joint venture and the individual venturers have in the technology. Here are some issues to consider:

For what purposes can the joint venture use the technology? What if those uses expand—or become obsolete—over time? If limitations on the scope of the license aren't spelled out now, there could well be trouble later as both the joint venture partner and the joint venture itself claim exclusive rights to put the technology to new uses.

Even if the parties' long-term plans aren't yet formulated, it makes sense to agree on whether the grant is for one purpose; for a list of specified purposes; for one

purpose and defined closely related purposes; or for all purposes except specifically identified purposes. The parties should be aware that silence on the issue of whether the initial grant of technology will be expanded in the future leaves the venture's ability to expand beyond its initial field in doubt. If the parties are not in a position to resolve the issue definitively now, it may be desirable to leave open the possibility of an expanded grant at a later time, perhaps within certain agreed parameters.

To what extent, if any, will the individual venturers get to use jointly developed technology or even the technology they contribute to the venture during the life of the joint venture? May the joint venture parties use the technology for any purpose not directly in competition with the joint venture? If so, will each party agree not to take actions to impair or disrupt the other's use of the technology, such as applying for patent protection or disclosing trade secrets? That approach might make the venture more attractive to a prospective alliance partner. What royalty, if any, will the joint venture partners have to pay to use jointly developed technology for non-competitive use? Will each new area of use have to be separately negotiated with the joint venture board? These are examples of the kinds of issues parties may want to consider, and negotiate, in advance.

Other technology-related issues joint venture partners might want to consider at this phase are:

- appropriate representations and warranties about the technology, including indemnification provisions. Do earlier representations and warranties need to be revised? Should they be extended?

- territorial restrictions on use of the technology

- duration of the grant

- bases for terminating the grant (and provisions for reallocating the technology if the grant, or the joint venture, is terminated)

- training commitments by the party who is contributing the technology

- technology performance guarantees

- royalty provisions and payment structure: up-front one-time fee? sliding scale? alternate forms of payment? what is to be the royalty base? is the royalty to be linked only to the patent? to know-how? what portion of the royalty is to be allocated to each (an important issue if the patent expires or is invalidated)

- treatment of improvements to the original technology: must they be licensed to the joint venture if developed by the technology owner during the term of the joint venture? at what price? Are improvements developed by the joint venture to be licensed back? under what terms?

- confidentiality procedures and monitoring techniques, perhaps including non-compete agreements

- the joint venture's right to license (or sublicense) its technology to others.

Every venture need not resolve, or even address, all these issues in its technology agreements, and certainly not in detail in the early agreements. A strategic relationship may go through several iterations as the technology and business needs change. But a wise alliance partner will give these issues early and serious thought throughout the course of the venture to make sure that the alliance documents serve the strategic goals of the party and of the alliance.