

## Feature

### KEY POINTS

- Article 22 sets out a relatively and seemingly standard confidentiality obligation. However, on closer inspection, art 22.1 is in some respects too narrow and in others too broad.
- The appropriate use by the joint venture ('JV') parties of confidential information of the JVCo raises difficult questions.
- Article 23.7 imposes many of the same fiduciary duties on the JV parties that partners or joint venturers would owe to each other in a common law legal system, thus treating the JVCo shareholders as partners.

Author Richard Keck

# Joint venture agreements: part 16 – duties of confidentiality and loyalty

Article 22 sets out a relatively and seemingly standard confidentiality obligation. However, on closer inspection, art 22.1 is in some respects too narrow and in others too broad.

Structurally, art 22.1 imposes duties of confidentiality directly on the JV parties, while art 22.2 requires the JV parties to impose those duties on their associated persons, who are not parties to the JVA. This is typical and good practice. Even better practice is to develop a form of non-disclosure agreement to be signed by all JVCo board members, personnel seconded by the JV parties to the JVCo and the JVCo's own personnel. The undertaking by the JV parties in art 22.2 is only as strong as its actual implementation, and such a non-disclosure agreement form can assist in ensuring rigorous implementation.

Article 22, as drafted in the model JVA, only applies to the JV parties and not to the JVCo. The JVCo will acquire its own legal and business personality and will likely be in possession of a significant amount of sensitive confidential information of the JV parties, such as financial information required to be reported to the government authority overseeing the licence, contract or concession, market and other competitive information of the JV parties and possibly derogatory information about the JV parties. The JV parties thus have good reason to bind the JVCo, which none of them controls, to the same obligations that apply to the individual JV parties under art 22. This is one reason an earlier instalment in this series recommended that the JVCo become a party to the JVA as soon as it has been incorporated.

Article 22.1 prohibits disclosure of confidential information by a JV party, subject to certain exceptions. However, art 22.1 does not restrict how a JV party (or the

This article is 16th in a series examining project development and finance joint ventures ('JVs') based on the International Trade Centre incorporated joint venture model agreement ('JVA') among three or more parties.<sup>1</sup> This instalment focuses on JVA arts 22 and 23, which address the related duties of confidentiality and loyalty of the JV parties and the joint venture company ('JVCo').

JVCo if the provision is made binding on the JVCo) may use another party's confidential information. This is a significant deficiency in the text of the model JVA.

Most confidentiality agreements directly restrict the use of confidential information to the purposes for which it was supplied, which in this case would be to enable the receiving party to perform its obligations and exercise its rights under the JVA. Although some of the duties imposed on the parties by art 23 (which is discussed below) may indirectly restrict the use of another party's confidential information, the protection afforded by art 23 alone against the misuse of confidential information may be inadequate. Accordingly, the lawyers for the JV parties should modify art 22.1 to restrict the use of confidential information to what the parties view as proper purposes based on the context of the JV.

Defining the appropriate scope of permitted uses of confidential information poses perplexing questions for the draftsmen of the JVA. Confidential information of the JV parties is easiest to address. It will typically have been supplied by the JV parties for a specific purpose in support of the JVCo. The JVCo has no business using it for any other purpose and the other JV parties likely have no business using it at all. Thus, the standard limitation on using such information solely for the purpose for which it was supplied is normally the appropriate limitation on use.

However, the appropriate use by the JV parties of confidential information of the

JVCo raises more difficult questions. One should keep in mind that such information may include confidential information supplied by third parties (such as suppliers or customers of the JVCo), as to which the JVCo itself has certain contractual duties of confidentiality. In most cases, the JV parties and their personnel serving the JVCo (as directors or seconded employees, for example) will simply need to observe and abide by the same duties as those undertaken by the JVCo to the third parties who have supplied the confidential information.

One should also keep in mind that the JVCo is likely to develop its own confidential and proprietary information, to which it owes no duty of confidence to any other person. Some of this information may also be valuable to one or more of the JV parties who have access to it through their relationship with the JVCo. When should it be permissible for those JV parties to use the JVCo's confidential information? The answer to this question takes us first back to art 2.2 of the JVA, which sets out the purposes of the JVCo, and then to art 23 (discussed below), which sets out the duties of loyalty of the JV parties to the JVCo. Where a JV party wants to use the JVCo's confidential information to pursue a business opportunity within the scope of the JVCo's business purpose, such use would be inconsistent with the duty of loyalty and should be prohibited.

On the other hand, where a JV party wants to use the JVCo's confidential

information to pursue a business opportunity that is clearly outside the scope of the JVCo's business purpose, then perhaps such use should be permitted. Indeed, it may very well be that access to such information that has independent value to one of the JV parties is one of the reasons that JV party was willing to invest in and support the JV. Under such circumstances, the other JV parties might willingly endorse the use of such confidential information by that JV party in a manner not in conflict with the purposes of the JVCo. If this is the case, subordinate issues to be addressed in drafting the JVA might include whether the JV party must seek authorisation from the JVCo for such use, or at least report the use to the JVCo, or whether it may do so without accounting to anyone. All these issues should be raised and addressed in drafting the JVA. How they should be handled will of course depend on the specific circumstances of the JV, the JVCo and the JV parties.

Article 22.1 prohibits disclosure of all 'business and technical information' of both the JV parties and the JVCo. There is no requirement that the information be marked or identified as confidential or that it possess properties that require it to be kept confidential (such as trade secrets or personal information) or that would otherwise lead the recipient to believe it is meant to be confidential. The scope of information covered is thus extremely broad, and for that reason alone may in some jurisdictions potentially render the confidentiality obligations in the model JVA unenforceable. In those jurisdictions that follow a 'blue pencil' rule, where courts rewrite a restrictive covenant so that it will be enforceable, the impact may only be to limit the scope of the confidentiality provision so it is legally enforceable (effectively rewriting it to how it should have been drafted in the first place). On the other hand, in jurisdictions without a 'blue pencil' rule, the JV parties may disappointingly find that the confidentiality clause is entirely unenforceable. The lawyers for the JV parties should consider limiting the scope of information to be protected to

certain defined categories that they agree in advance should be treated as confidential in order to ensure its enforceability. Examples of well-drafted definitions of confidential information abound and further discussion of that topic is beyond the scope of this instalment.

Article 22.1 also has perpetual duration. Again, this may not be enforceable in some jurisdictions. More typically, a confidentiality agreement protects information from unauthorised use or disclosure for some specified term of years (essentially until the protected information would reasonably be considered stale or obsolete), with exceptions for things like trade secrets and personal information, which may continue to be protected for a longer or even an indefinite period.

## "Article 23 imposes on the JV parties duties of good faith, consultation, non-competition and promotion of the interests of the JV."

The exceptions in art 22.1 are typical and expressed succinctly. The first exception relieves a party of its duty of confidentiality if the information is or becomes public knowledge without fault of that party. The second allows a party to disclose confidential information 'to the extent' required to be disclosed to a regulatory or governmental authority or otherwise by law. This presumably includes a court order or subpoena, but these should be expressly added. If the second exception applies, the party divulging another party's confidential information is required to keep the other parties informed of such disclosure. This proviso falls short of what one often sees, which is an express obligation to give the party whose confidential information is being disclosed as much advance notice as possible in order to afford that party an opportunity to seek a protective order. It also is less clear than some provisions in directing the party required to make a disclosure to limit that disclosure to the greatest lawful extent possible. The qualifier 'to the extent' appears intended to have that

purpose, but it is worth spelling this out.

Finally, as is customary, art 22 survives termination of the JV (as discussed in the previous instalment of this series). One nuance that the JV parties may consider adding is that art 22 only survives with respect to disclosures made up to a specified point in time, such as the date the JVA terminates. Because the JVA will have been terminated, the JV parties will no longer be under a continuing duty to each other with respect to new disclosures of information. If two or more of them want to continue discussing confidential matters, then they can enter into a subsequent non-disclosure agreement. However, each JV party will otherwise no longer have to monitor unsolicited information and disclosures it may receive from the others out of concern

that a duty of confidence may attach to information received.

The model JVA's companion to art 22's duty of confidentiality is art 23's duty of loyalty. As its title indicates, art 23 imposes on the JV parties duties of good faith, consultation, non-competition and promotion of the interests of the JV. Loosely speaking, this bundle of duties might be considered as each JV party's duty of loyalty or duty of fidelity to the other JV parties and to the JVCo.

Article 23.1 sets out these duties in general terms. To some degree, the duties seem implicit in the relationship among the JV parties, and indeed they are, but these implied duties tend to vary in nature and strength from one jurisdiction to the next so it is always better to set them out as express duties as the model JVA does.

In particular, art 23.1 of the model JVA sets out three general duties. First, each JV party must use all reasonable efforts to promote the best interests of the JVCo. Secondly, each JV party must use all reasonable efforts to consult fully on all

## Feature

### Biog box

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matters materially affecting the development of the business of the JVCo. Third, each JV party must act in good faith.

It is noteworthy that the first two duties require 'all reasonable efforts', a concept that is thought to have its own legal meaning and is not defined in the JVA. One might encounter stronger or weaker formulations. The strongest is to remove the 'efforts' concept entirely and simply to say, for example, that each party 'shall promote the best interests of the JVCo'. Also potentially stronger is the concept of using 'best efforts'. On the weaker side are the concepts of 'commercially reasonable efforts' or simply 'reasonable efforts', as opposed to 'all reasonable efforts'. The weakest formulation of all might be 'shall endeavour'. The author has observed many negotiations where the lawyers go back and forth over these alternative formulations, but little or no legal research is carried out to confirm whether they make any difference and, if so, what difference. The lawyers for the JV parties would do well to discuss with their clients the appropriate level of commitment to these principles when the interests of the JVCo come into conflict with those of a JV party. It is also worthwhile to check whether these terms of art have any understood meaning in the jurisdiction whose law will govern the JVA.

As in the case of the art 22, the model JVA does not in art 23 impose any duties on the JVCo, and instead only imposes them on the JV parties. Again, the author recommends that at least the second and third duties, consultation and good faith, be imposed directly on the JVCo as well.

Articles 23.2 to 23.7 set out certain specific instances of the more general duties contained in art 23.1. Article 23.2 requires each JV party not to unreasonably *withhold* its consent or approval where the same is required. Consistent with current best practices, this clause should be modified to say that the consent or approval will also not be unreasonably *delayed*. It is not uncommon for a party wishing to block a requested action, but not be held liable for wrongfully withholding its consent, to give assurances that it is processing the request even as it

deliberately delays action with the intention of frustrating the efforts of the party who sought the approval or consent.

Article 23.3 obligates each JV party to ensure that its representatives attend JVCo shareholder and board meetings and do not create a deadlock by non-attendance. A further nuance that might be added, to the extent the JV parties want to include this concept in the JVA, is to state that each JV party must not attempt to prevent a quorum for the transaction of business at a shareholders or board meeting through non-attendance. However, depending on the number of JV parties and their relative interests in the JVCo, the approval requirements for certain actions and other

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relevant factors, some JV parties might want the right to use their non-attendance as a governance tool to block certain actions by delaying a decision that they could not block if a meeting were held. The lawyers drafting the JVA must therefore consider the consequences of this provision for their clients in the future, and determine whether they want to retain their clients' ability to delay a decision (perhaps while they try to persuade other JV parties to follow a different course than that proposed) by not showing up and thereby blocking a quorum.

Article 23.4 provides that a JV party and its board representatives may not vote on matters relating to disputes between such JV party and the JVCo. In the case of directors, this is typically the law in most jurisdictions, ie that only disinterested directors may vote. However, the restriction on shareholder voting is unusual, as shareholders do not generally have fiduciary duties and should be permitted to register their interests through voting. Again, the lawyers drafting the JV should consider whether it is fair for the affected JV party to have no say in how the JVCo responds to a dispute with it.

Article 23.5 provides that any contract between a JV party and the JVCo must be on an arm's-length basis and not unfair to the other JV parties. The author recommends being more explicit, and requiring any transaction between a JV party or an associated person and the JVCo to be approved by the disinterested directors of the JVCo.

Article 23.6 provides a non-compete between each JV party and the JVCo. It does not define the scope of business that is restricted, although one can again look to the purposes of the JVCo as set out in art 2.2. It is advisable to make an explicit reference to art 2.2 in art 23.6. The lawyers for the JV parties should also consider

whether this should be reciprocal so that the JVCo agrees not to compete with certain businesses reserved to its JV party shareholders. The JV parties and their lawyers must also pay careful attention to any applicable competition or antitrust laws and ensure that art 23.6 is not considered an unlawful agreement in restraint of trade.

Article 23.7 imposes on the JV parties a duty to exercise their voting rights to fulfill the provisions and principles of the JVA. This is a broad undertaking and imposes many of the same fiduciary duties that partners or joint venturers would owe to each other in a common law legal system. It thus treats the JVCo shareholders as partners.

In conclusion, the model JVA provides a good framework for imposing duties of confidentiality and loyalty on the JV parties (and the JVCo if it is added as a party to the JVA). With the recommended changes, it provides solid support for ensuring the JV operates as smoothly and successfully as possible. ■

1 The model JVA discussed may be found at [www.jurisint.org/doc/orig/con/en/2005/2005jiconen1/2005jiconen1.pdf](http://www.jurisint.org/doc/orig/con/en/2005/2005jiconen1/2005jiconen1.pdf).