

## Feature

### KEY POINTS

- The mutual attraction that leads JV parties to venture together usually involves the ability of some or all of them to contribute more than simply money.
- Where these additional contributions will not be treated as in-kind contributions for shares under art 4, the drafting lawyers can address them in arts 13 and 14 of the model JVA, and related management agreement, other services agreements and/or intellectual property licence agreement with the JVCo.
- In many ways, the substance of these ancillary agreements has much more bearing on the success or failure of the JV than the JVA itself.

Author Richard Keck

# Joint venture agreements: part 12 – JV party services and intellectual property

In a start-up project JV, the JV parties have typically chosen to venture together not only because of the financial contribution each can make but also because of the in-kind contributions that some or all of them can make to the JV. Part 1 of this series noted that some JV parties may be entitled or expected to provide management, outsourcing or other services to the JV – both before and after incorporation of the JVCo. Part 1 also noted that the JV parties may second employees to the JVCo and transfer or license intellectual property to the JVCo. These matters are covered in arts 13 and 14.

Article 13 anticipates that the drafting lawyers will set out the duties of some or all JV parties to provide such services to the JVCo. Article 13.1 lists those JV parties that will be responsible for ‘providing or organising’ various ‘technical or commercial services’ within the scope of the JVCo’s activities. As examples, the drafters’ notes list administrative or IT support, tax or other professional services, supply of materials, marketing or distribution services.

Article 13.2 indicates that these services are in addition to in-kind contributions for shares required under art 4 and ‘shall be provided free of charge’. The model JVA also suggests two alternatives, one involving payment and other terms approved by the JVCo’s board and the other involving terms set out in an ancillary agreement between the JVCo and the relevant JV party. Unless all JV parties provide comparable levels of service or the amount of such services is relatively nominal, each JV party providing services to the JV will usually insist on being compensated for those services, whether in cash (per art 13.2) or by the issuance of shares (per art 4). The ‘free of charge’ concept in art 13.2 thus has limited application in practice.

This article is twelfth 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 13 and 14, which address technical and administrative services provided by JV parties to the joint venture company (‘JVCo’) and the mutual rights and duties of the JV parties and JVCo regarding intangible assets and intellectual property rights.

Article 13.3 provides that the JVCo will bear the cost of any personnel seconded by a JV party, again on terms to be approved by the JVCo’s board. Finally, art 13.4 sets out a performance warranty, requiring each JV party to ‘use reasonable care and skill’ in carrying out its duties under art 13.

In the author’s experience, the types of services contemplated in art 13 are almost always set out in an ancillary agreement unless they are relatively incidental to participation in the JV and/or nominal in effort and value. The most comprehensive, and relatively common, ancillary agreement for a project JV is a ‘management agreement’ or ‘management services agreement’.

As noted in part 11, the author recommends omitting model JVA art 12 in a project JV, but this does not mean the JV does not have a leader. In most JVs, one JV party has provided leadership in organising the JV and recruiting the other JV parties. This leadership role may subside after the JV parties enter into the JVA. However, the JV party that led the formation of the JV is oftentimes envisioned as entering into a management agreement with the JVCo and continuing to provide leadership and management services to the JV, through the incorporated JVCo.

One fundamental and threshold issue is whether the management services relationship will be permanent or merely transitional, and, if the latter, for how long. If the JV parties have not fully thought this through, which is

surprisingly common, then the lawyers will need to help them do so when drafting the JVA and its ancillary agreements. Where the management relationship will be permanent, the JV parties may not envision the JVCo as becoming a fully independent stand-alone business. This is sensible where the project size is not large enough to support all the functions required for a fully independent operating business or where the managing JV party brings vast resources and skills, and economies of scale, that cannot be economically replicated in the JVCo.

In addition, as discussed in the first instalment of this series, in some projects, the licensing authority or other government authority that issues a licence, grants a concession or enters into a contract may require the JVCo to have a management agreement with the JV party on whose skill and experience it relied in selecting the JVCo for the licence, concession or contract. The JVCo’s licence, concession or contract may also dictate certain elements and terms of the management agreement. For example, it may determine the minimum scope of authority and responsibilities of the managing JV party and the minimum duration of the management agreement. These requirements are typically context specific, and must be addressed by the lawyers on a case-by-case basis.

A major challenge in drafting any management agreement and the related JVA is the interplay between the governance

provisions of the JVA (including those defining the governance roles of the JVCo's shareholders, board and officers) and the role of the managing JV party under the management agreement. The management arrangement creates inherent tensions over who will be in charge of the JVCo's business. Subject to any required terms under the licence, concession or contract, the lawyers will need to parse through these issues. For example, the JVA/management agreement combination must allocate responsibility for developing and approving the JVCo's capital and operating budgets between the managing JV party and the JVCo's board. The more authority retained by the board, the less the managing JV party can be held accountable for the adequacy or purposes of the budgeted amounts. These are nettlesome issues to work through. The managing JV party should also take care to avoid being exposed to shadow director liability through the exercise of too much control over the JVCo.

Another significant issue to address in a management agreement is the basis on which management fees will be calculated and paid. The JV parties may try to reduce their start-up capital needs by agreeing to a management fee that only becomes due and payable when the JVCo has revenue and/or positive cash flow. It is thus not uncommon for a management fee to be based on a percentage of revenues or net positive cash flow. Such an arrangement, while reducing the JVCo's capital cash requirements, and hence the financial burden on the other JV parties, also requires the managing JV party to accept deferred payment as well as additional risk. These factors will weigh into the choice of an appropriate management fee. Some industries have rules of thumb for management fees, such as an applicable percentage of revenues, but may involve relatively uncharted territory for the lawyers and their clients.

Through the cooperative efforts of the lawyers and financial advisers, the JV parties should ensure that the formula chosen for the management fees properly aligns the interests of the managing JV party with the other JV parties. Thus, a management fee payable as a percentage of revenues may or may not

properly align interests. If the managing JV party is appropriately constrained to maximise revenues within parameters that ensure costs are also controlled, and long-term value and assets are established and preserved, then the interest of the parties may be aligned. However, if the managing JV party is incentivised to increase revenue by overspending on marketing and thereby to generate negative and suboptimal cash flow for the JVCo, then the interests of the JV parties may not be aligned.

Apart from the tension between the managing JV party and other JVCo governance mechanisms, the lawyers must also address the loyalties of JVCo

personnel. Are those persons in senior positions largely to be seconded by the managing JV party or will they be hired directly by the JVCo? Who will make the hiring and firing decisions and to whom will these people report and owe fealty? The answers to these questions depend, in part, on the answer to the earlier question, ie whether the management relationship is intended to be permanent or transitional. If permanent, the JVCo's senior staff are effectively an extension of the personnel of the managing JV party. If transitional, then the lawyers for the JV parties should ensure that, at the appropriate time, the JVCo is able to hire and groom its own independent management who can assume control and management of the JVCo's business when the management services agreement expires.

In addition to these threshold issues, the lawyers must address the specific services to be provided by the managing JV party (or, if the scope of work is more limited than 'management', the specific services agreement required). On this front, the agreement can be modeled on any typical arm's-length services agreement. Types of services commonly encountered include procurement

of materials and services for construction of the project, project management, engineering and technical services, financial, accounting, tax and regulatory services, recruiting and personnel services, marketing and sales services, and operations and maintenance services. Although the model JVA includes as Appendix 5 a model 'Ancillary Agreement on contributions in services', it is very bare bones and of limited help in drafting a management or other agreement by which a JV party will supply services to the JVCo. It is beyond the scope of this series to delve into the details of such agreements, but the lawyers should be able to find ample precedents for any particular ancillary agreement.

"Article 14.2 can be drafted to allow every JV party to use the JVCo's intellectual property for its own business purposes, even potentially free of charge."

A topic closely related to the provision of services to the JVCo by one or more JV parties is their contribution or licensing of intellectual property and other intangible assets to the JVCo. Article 14 addresses these contributions, as well as the reciprocal rights, if any, of the JV parties to use intellectual property and intangible assets of the JVCo. Article 14.1 contemplates that the drafting lawyers will set out those arrangements by which the JV parties make intangible assets or intellectual property available for use by the JVCo in separate ancillary agreements. Suggested forms are set out in Appendices 2 and 3 of the model JVA, which are again quite rudimentary and not of much help.

Article 14.2 states that the intellectual property developed by the JVCo is for its exclusive use and may not be used by any JV party without the approval of the other JV parties and then only on terms approved by the JVCo's board. As an alternative, art 14.2 can be drafted to allow every JV party to use the JVCo's intellectual property for its own business purposes, even potentially free of charge. The provision can thus be customised based on the nature of the JVCo's business and the relation of each JV party to that business, such as whether

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### Biog box

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there is potential for competition between a JV party and the JVCo.

Any JV party providing services to the JVCo will inherently employ its know-how, and potentially its intellectual property, to supply the relevant services to the JVCo. It is customary to include, in the services agreement, a non-exclusive licence for the JVCo to use that know-how and intellectual property, while confirming that the JV party retains ownership. It is also common for the remuneration payable to the transferring/licensing JV party for services to be inclusive of the right to use such know-how and intellectual property.

However, where the intangible assets or intellectual property to be licensed by a JV party to the JVCo are more than merely incidental to the services, if any, it provides to

markets such as roaming arrangements offered by telecom operators to their customers, or loyalty programs whereby the JVCo's customers can benefit from combining purchases from the JVCo with purchases made from other businesses owned by a JV party or its affiliates.

The licensing of trade and service marks, and related brands, is particularly common in project JVs that offer services in competitive mass markets. A particularly apt example is the common branding of telecom networks across different geographic markets, where the ownership of the network in each market is distinct, but the licensor who owns the brand is a shareholder (minority, majority or 100 per cent) of the network operator in each geographic market. These situations typically involve the same JV party having

large scale capital intensive industries such as telecom and utilities, these sorts of systems are often fully custom or off-the-shelf with significant customisation. The incremental cost to a JV party owning such intellectual property in making it available to the JVCo may be minimal, while its use creates greater consistency across all projects and businesses managed by the JV party and hence makes its services under the management agreement more effective and efficient. It can also help the JVCo avoid significant capital outlays that might otherwise be required to develop or acquire these systems on its own. This contribution of resources by a JV party, initially and on an ongoing basis, is valuable to all the JV parties and will likely be taken into account in determining the amount of consideration payable to the contributing JV party, whether as additional dividends (where the contribution is considered as in-kind for shares), additional management fees or royalties for use of the assets and property.

The provision both of services and intellectual property to the JV by JV parties often begins before the JVA is even signed and/or the JVCo is incorporated. The lawyers for the JV parties may therefore need to ensure that the JVA, the management agreement or ancillary agreements address services and property which were made available before the signing of the JVA and incorporation of the JVCo.

In conclusion, the mutual attraction that leads JV parties to venture together usually involves the ability of some or all of them to contribute more than simply money. Where these additional contributions will not be treated as in-kind contributions for shares under art 4, the drafting lawyers can address them in arts 13 and 14 of the model JVA, and related management agreement, other services agreements and/or intellectual property licence agreement with the JVCo. In many ways, the substance of these ancillary agreements has much more bearing on the success or failure of the JV than the JVA itself. ■

## "A JV party may also license software and other material protected by copyright to the JVCo."

the JVCo, then the drafting lawyers should consider a separate licence agreement. The types of intangible assets and intellectual property commonly licensed by a JV party to the JVCo can include trade and service marks, software and other materials protected by copyright, trade secrets and patents. In some cases, licensed intangible assets might include access to a customer prospect list owned or maintained by a local JV party that could be valuable in the JVCo's customer acquisition efforts. For example, the owner of the retail electronics business discussed in the first instalment of this series may be able to lend its customer list to the JVCo to market telecom services.

A JV party may also make certain other intangible assets available to the JVCo, such as buying arrangements with vendors whereby the JVCo can benefit from preferred customer status and volume discounts available to the contributing JV party (which could be particularly useful in the project development and construction phase), relationships whereby the JVCo's customers can benefit from the operations of a JV party in other

a management services agreement with the JVCo, and are often cases where the duration of the management relationship is permanent or long-term.

Although there may be a separate licence fee for the trade and service marks, they are often considered commercially as part of the overall bundle of services to be provided by the managing JV party in exchange for the management fees. For tax and regulatory purposes, however, it may be necessary or useful for the agreements to specify the allocation of the total consideration among the management services, intellectual property licences and other property or services provided. The tax impact on the managing JV party from these different payments, particularly withholding taxes on cross-border payments, may depend on the category into which they fall.

A JV party may also license software and other material protected by copyright to the JVCo. This could include financial and accounting systems, customer relationship management systems, network or plant operations software, and the like. In very

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).