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**Drafting Intellectual Property Joint Venture Agreements
with an Eye Toward Termination**

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Introduction

When joint venture (“JV”) parents come together with a business idea, they expect to develop the resulting intellectual property (“IP”) to the benefit of all parents. The joint venture agreement (“JVA”) is crucial to the formation and operation of the IP JV. Careful drafting will account for the parties’ expectations regarding the parents’ and the JV’s IP. However, the parties should realize that the JVA is also crucial to the termination of the JV. The JV parents must accept the reality that all JVs must come to an end, and some JVs will come to an end sooner than one of the parties might have wished. Therefore, parties to the JVA should devise a plan for termination in advance.

JVA’s generally address the termination stage of the JV. However, JV parents must draft the termination clause and the entire agreement with an eye towards hostile termination—when one parent may want to continue the JV whereas the other parent may want to terminate the JVA. Parents must draft the JVA specifically to account for the contingencies of breach of the JVA, business problems, or insufficient revenue. If the parties do not address changed circumstances or expectations in their JVA, the courts will interpret the agreement according to established contract interpretation principles. However, this may not lead to the best disposition of the IP involved.

I. Drafting the Joint Venture Agreement

Joint venturers must draft the JVA to prevent termination yet also to account for withdrawal. The JVA can address issues such as conflict-resolution and governance with an aim of promoting either coordination or flexibility. “There are three theoretical contracting modes associated with [JV’s]: classical, neoclassical, and relational.”¹ Classical contracts maximize “coordination at the expense of flexibility.”² Their scope is limited to an individual transaction, and they are “presentiated”—that is, they “fix at the time of contracting precise expectations for future performance and the remedies available in the event of breach.”³ Neoclassical contracts incorporate governance structures rather than being completely presentiated.⁴ Relational contracts are “the most flexible, emphasizing organic development of collaboration in response to changes in business climate.”⁵ Relational contracts are receptive to modification rather than specifying expectations on the front end.⁶

Relational contracts best serve the purpose of preventing termination. Rather than encompassing only an individual transaction, relational contracts allow for growth of the JV and expansion into new markets. Their flexibility allows the parties to respond to changes in expectations or circumstances while still being governed by the JVA, rather

¹ Steven R. Salbu & Richard A. Brahm, *Strategic Considerations in Designing Joint Venture Contracts*, 1992 COLUM. BUS. L. REV. 253, 255 (1992).

² *Id.* at 256.

³ *Id.* at 255–256.

⁴ *Id.* at 256.

⁵ *Id.*

⁶ *See id.*

than compelling termination. However, the parties must account for withdrawal in the JVA, and the best way to do that is to coordinate withdrawal in advance by presentation.

A. Drafting to Prevent Termination

Joint venturers can ensure performance of commitments and increase compliance with contractual terms by including incentive schemes. Collaborative incentives are contractual mechanisms such as “reciprocal penalties,” “rewards for altruism,” and “bundling of commitments.”⁷ A reciprocal penalty “exacts a charge upon the violating partner equivalent to its transgression.”⁸ Such a charge reduces the likelihood that a parent will cause damage to the other parent. The opposite is a reward for altruism which rewards a parent for conferring a benefit either on the other parent or on the JV.⁹ Such a reward increases the incidence of the desirable behavior. Bundling of commitments can be a way of implementing penalties and rewards.¹⁰ “Bundling provisions in the [JVA] tie various commitments into a web of contingency. Duties of parent A become triggered by the occurrence of an act by parent B, or else parent A is relieved of a duty by virtue of nonperformance on the part of parent B.”¹¹ These collaborative incentives contribute to the flexibility of relational contracts which prevents termination.

B. Drafting to Account for Withdrawal

Joint venturers must provide for the withdrawal of any party to the JVA. “There is no point pegging partners down irrevocably because those who wish to leave the [JV]

⁷ See *id.* at 298-302.

⁸ *Id.* at 299.

⁹ See *id.* at 300.

¹⁰ See *id.* at 301.

¹¹ *Id.*

will procure reasons . . . even seeking a solution in litigation.”¹² Because of the possibility that a parent will leave the JV, the parents must decide in advance how much market freedom they will have after a party leaves the JV and they are no longer partners.¹³ The JV parents must regulate competition, or the lack thereof, territories, products, and distributors before a party withdraws.¹⁴ The parties to the JVA should also decide what will happen to ancillary contracts, such as licenses, and to intellectual property. Presentiated contracts that coordinate withdrawal in advance are the best way for joint venturers to account for withdrawal.

II. Levels of Termination

When conflicts arise between parties to a JVA, the parents have a choice of outcomes that ranges from amendment of the JVA, to rescission of the JVA, to termination of the JVA, to termination of the JV. Amendment or rescissions of the JVA are less severe than actual termination of the JVA or the JV. Rescission and termination of the JVA can be distinguished by the terms of the contract. Rescission may either be a unilateral unmaking of a contract or a mutual agreement to discharge contractual duties, but termination “refers to the discharge of duties by the exercise of a power *granted by the agreement.*”¹⁵ When the JVA is terminated, the JV may still continue, and certain contractual obligations may continue as well.¹⁶ Termination of the JV is an extreme

¹² RONALD CHARLES WOLF, *EFFECTIVE INTERNATIONAL JOINT VENTURE MANAGEMENT: PRACTICAL LEGAL INSIGHTS FOR SUCCESSFUL ORGANIZATION AND IMPLEMENTATION* 234 (2000).

¹³ *See id.* at 444.

¹⁴ *See id.*

¹⁵ BLACK'S LAW DICTIONARY 1308 (7th ed. 1999) (emphasis added)(citing CALAMARI, JOHN D. & JOSEPH M. PERILLO, *THE LAW OF CONTRACTS* § 21-22, at 854-65 (3d ed. 1987)).

¹⁶ *See WOLF, supra* note 12, at 444-45 (describing the continuation of collateral contracts upon termination of the JVA). In addition to

outcome, but it is rarely the subject of litigation. Termination of the JV by its nature means that neither party wants to continue the JV, which is a meeting of the minds and not a conflict. Of these various possibilities, termination of the JVA is the most common outcome when conflicts arise and is the most common subject of litigation.

III. Termination of the Joint Venture Agreement

There are many reasons for termination of a JVA: failure of a pre-closing condition; expiration of the term of the JVA; one of the parties goes into bankruptcy; there is a change of control of one of the partners; expropriation of the JV's assets in an international JV; business objectives or goals are not reached; income or revenue is not generated; force majeure; deadlock; one parent breached the JVA; or the JV breached the JVA.¹⁷ More than one of these events may occur simultaneously. A party might terminate a JVA because the JV is breaching the JVA, but the terminating party is materially breaching the JVA as well. Or, a party might terminate a JVA because of failure of the JV to generate revenue, but this early termination of a JVA may itself be a breach of the JVA.

The reasons for termination that are most likely to result in litigation are that a parent or the JV breached the JVA, the parties did not reach business objectives or goals or had business problems, or insufficient income or revenue was generated. Litigation concerning break-up of joint ventures tends to be very complicated, involving numerous plaintiffs, defendants, contracts, and claims. The non-terminating party or parties will

continuation of other contracts, some clauses of the JVA will survive termination of the agreement. *Id.*

¹⁷ See *id.* at 439-42; Michael E. Hooton, *Structuring and Negotiating International Joint Ventures*, 27 CREIGHTON L. REV. 1013, 1028 (1994).

bring claims such as breach of contract, breach of fiduciary duty, fraud, failure to transfer business, competition with the JV (which could be a breach of contract or a fiduciary duty claim), and third-party beneficiary claims. Sometimes the terminating party will bring counterclaims for the reasons that led to its termination of the JVA. Often there are allegations that the reasons for termination are a pretext for the terminating party's desire to sponsor a different venture or conduct business with a different partner.

A. Termination Due to Breach of the Joint Venture Agreement

In *Arrowroot Natural Pharmacy v. Standard Homeopathic Co.*, one of the JV parents, Standard Homeopathic Company ("Standard"), gave notice of intent to terminate the JVA if the JV did not cure its alleged breaches of the JVA.¹⁸ Standard and the other JV parent, Arrowroot Natural Pharmacy ("Arrowroot Pharmacy"), had formed a JV, incorporated as Arrowroot Standard Direct ("Arrowroot Standard"), with Arrowroot Pharmacy owning 667 of the outstanding shares of stock and Standard owning the remaining 333 shares.¹⁹ Parent Standard granted the JV Arrowroot Standard "exclusive rights and privileges regarding the sale of certain homeopathic drugs."²⁰ Arrowroot Standard would sell homeopathic products manufactured by Standard in specific markets within the United States, in particular the "Professional Mail Order" and "Retail Mail Order" classes of trade, and would compound, sell and distribute extemporaneous items²¹ to the "Professional Mail Order," "Retail Mail Order," "Pharmacy," and "Natural Foods"

¹⁸ *Arrowroot Natural Pharmacy v. Standard Homeopathic Co.*, No. 96-3934, 1998 U.S. Dist. LEXIS 1327, at 6 (E.D. Pa. Feb. 10, 1998).

¹⁹ *Id.* at 3.

²⁰ *Id.* at 1.

²¹ "Extemporaneous items are items not manufactured by Standard in bulk quantities. The definition of an 'extemporaneous product' as used within the homeopathic industry is a product 'produced in small quantity in reaction to an order received that are not intended to be stored in a shelf.'" *Id.* at 4.

classes of trade.²² The owner of parent Arrowroot Pharmacy, Joseph Carapico, his wife and daughter purchased a building to house the JV operations. Then they modified it to meet state and federal requirements for pharmacy, medical compounding, and storage, and they installed a telephone and computer ordering system that integrated the wiring.²³ Since opening the new facility, the Carapicos had invested at least \$400,000 into Arrowroot Standard. One month prior to Standard's letter seeking termination, Arrowroot Standard had five or six full-time employees and nine or ten part-time employees, not including Mr. Carapico.²⁴

1. *Claims*

Arrowroot Standard and Arrowroot Pharmacy sued Standard, seeking monetary damages and an injunction precluding Standard from terminating or otherwise violating the JVA.²⁵ Plaintiffs

allege[d] that defendant breached the [Joint Venture] Agreement by not turning over orders for extemporaneous products. In addition, plaintiffs allege[d] fraud arising from representations of Standard, and assert[ed] Standard's breach of its duty of good faith as a joint venturer because it appropriated for itself, or a wholly owned subsidiary formed for that purpose, related business that was the subject of the joint venture. The Amended Complaint also allege[d] the diversion of business by Standard for the purpose of harming plaintiffs and to take over the joint venture's business and induce sale of Arrowroot Standard's facilities at a distress price.²⁶

²² *Id.* at 3-4.

²³ *Id.* at 10.

²⁴ *Id.* at 11.

²⁵ *Id.* at 6-7 (internal quotation marks omitted).

²⁶ *Id.* at 12.

Standard counterclaimed alleging breach of the JVA and fraud. In its counterclaim, Standard claimed that plaintiffs failed to pay defendant royalties on extemporaneous sales and that plaintiffs are indebted to defendant by failing to make timely payments for goods received. Furthermore, Standard alleged that plaintiffs violated the JVA by preparing the financial books not in accordance with GAAP and that plaintiffs intended to defraud defendant.²⁷

2. *Ruling and Reasoning*

The U.S. District Court for the Eastern District of Pennsylvania, applying Pennsylvania law,²⁸ awarded plaintiffs damages and enjoined the defendant from terminating the JVA until plaintiffs were given an opportunity to cure default.²⁹ Standard's counterclaims were its bases for terminating the JVA. The court held entirely in favor of the plaintiffs on two of the counterclaims. The court stated, "defendant has not proven that Arrowroot Standard has breached the [JVA] by failing to pay the accounts receivable on a timely basis,"³⁰ and "defendant has not established by clear and convincing evidence that plaintiffs committed fraud"³¹ Thus, Standard could not use those reasons as justification for terminating the JVA.

²⁷ *Id.* at 25-30.

²⁸ *See id.* at 30.

²⁹ *See id.* at 44-45. Paragraph 7.01(a)(1) of the JVA provides that Standard and Arrowroot Standard may terminate the JVA "if any of the following events occur:

"Breach or default by either party of any of the terms, obligations, covenants, under this Agreement which is not waived in writing by the affected non-breaching party. In such case the non-breaching party shall notify the breaching party of such alleged breach and the breaching party shall have a period of thirty (30) days to cure same." *Id.* at 5.

³⁰ *Id.* at 38.

³¹ *Id.* at 45.

On defendant's royalties counterclaim, the court held that Arrowroot Standard owed Standard royalties pursuant to the JVA for the sales of extemporaneous products.³² However, "[t]he failure of Arrowroot Standard to remit royalty payments to Standard for sales of extemporaneous products cannot be a basis for termination of the [JVA] at this time since Arrowroot Standard was justified in suspending its obligation to pay royalties because Standard materially breached the [JVA] by not transferring all of the extemporaneous business to Arrowroot Standard."³³

On defendant's financial books counterclaim, the court held that "defendant has proven that plaintiffs failed to comply with GAAP when it prepared its financial statements."³⁴ Moreover, Standard was entitled to terminate under Paragraph 7.01 of the JVA, and the termination clause is enforceable.³⁵ However, the court considered principles of equity. If Standard terminated the JVA, the majority shareholder Arrowroot Pharmacy would forfeit its investment in the JV, which amounted to over \$400,000.³⁶ Quoting a Pennsylvania Superior Court case, the court stated, "Equity . . . abhors a forfeiture and is greatly hesitant to enforce one."³⁷ The court used the equitable doctrine of substantial performance to prevent the forfeiture.³⁸ The court found that Arrowroot Standard's non-performance of all of the terms of the JVA, including failure to maintain

³² *Id.* at 36-37.

³³ *Id.* at 37.

³⁴ *Id.* at 38.

³⁵ *See id.* at 39-40.

³⁶ *Id.* at 40.

³⁷ *Id.* (quoting *Kalina v. Eckert*, 497 A.2d 1384, 1385 (Pa. Super. Ct. 1985)).

³⁸ *See id.* at 40-41. "When a party has honestly and faithfully preformed all material elements of its obligations under a contract, but has failed to fulfill certain technical obligations, causing no serious detriment to the injured party, it would be odious and inequitable to compel forfeiture of the entire contract.'" *Id.* (quoting *Barracough v. Atlantic Refining Co.* 326 A.2d 477, 480 (Pa. Super. Ct. 1974)).

financial statements in accordance with GAAP and to pay royalties, was justified by Standard's material breaches of the JVA, which included failure to turn over all extemporaneous business³⁹ and to afford Arrowroot Standard the best wholesale price as required by the JVA^{40,41}. Standard's breaches prompted Arrowroot Standard's refusal to pay royalties and to prepare its accounting records in accordance with GAAP.⁴² "The court further [found] that, other than the two instances cited above, Arrowroot Standard has substantially performed all of its obligations under the [JVA]."⁴³ The court concluded that "defendant cannot terminate the [JVA], at this time."⁴⁴ The court enjoined defendant from terminating the JVA for a thirty day period, during which time plaintiffs were given an opportunity to cure the two defaults alleged by defendant.⁴⁵

3. *Principles*

Arrowroot Natural Pharmacy applied basic contract law principles to decide whether to allow termination in response to breach of the JVA. In summary, if a contract allows a party a period to cure default, then the other party cannot terminate. If one party materially breaches a contract and then the other party does not perform, if the non-

³⁹ *Id.* at 41. On plaintiffs' breach of contract claim regarding failure to transfer extemporaneous business, the court held that "[t]he intentional decision of Standard not to transfer all the extemporaneous orders required by the [JVA] is a material breach of the Agreement." *Id.* at 31. The court awarded plaintiffs \$7,300, the amount Arrowroot Standard would have received from the sale of extemporaneous items withheld by Standard. *Id.* at 33.

⁴⁰ On plaintiffs' breach of contract claim regarding the price of Standard's products, "[p]laintiffs have proven that defendant materially breached the [JVA] by not giving this discount [equal to the price of one item when the purchaser buys a dozen or more quantities of the same item] as required by the terms of the Agreement." *Id.* at 36. The court awarded plaintiffs \$41,520 on this claim. *Id.*

⁴¹ *See id.* at 41-42.

⁴² *Id.* at 42.

⁴³ *Id.*

⁴⁴ *Id.* at 43.

⁴⁵ *Id.* at 44.

performing party was justified in response to the breaching party, then the breaching party may not terminate. If one party substantially performs the contract, then the other party cannot terminate.

B. Termination Due to Business Problems or Failure to Reach Business Goals

The subject of *Kindergartners Count, Inc. v. DeMoulin*⁴⁶ is an intellectual property partnership that is instructive for intellectual property JVs. It is well-known that “the American legal system treats joint ventures as pseudopartnerships; partnership principles are applied to problems or conflicts in joint ventures.”⁴⁷ In *Kindergartners Count*, Kindergartners Count, Inc. (“KCI”) entered into a Partnership Agreement with Telephone Pioneers of America (“TPA”). KCI, a non-profit exempt organization, was the copyright owner of “I Like Me!” (“ILM”), a personalized children’s book, and the ILM Teacher’s Guide.⁴⁸ The purpose of the partnership was to have local units of TPA, a domestic fraternal society, work with schools and other interested community groups to distribute KCI’s ILM program.⁴⁹ Additionally, KCI entered into a Consulting Agreement with Donald DeMoulin, a professor of education. Under the agreement, DeMoulin was to provide KCI with educational, training, publication, and research consulting services as they related to the ILM program;⁵⁰ he was an independent contractor of KCI;⁵¹ and he

⁴⁶ *Kindergartners Count, Inc. v. DeMoulin*, No. 00-4173-JAR, No. 01-4017-JAR, 2003 U.S. Dist. LEXIS 4212 (D. Kan. Mar. 13, 2003).

⁴⁷ Adam B. Weissburg, Note, *Reviewing the Law on Joint Ventures with an Eye Toward the Future*, 63 S. CAL. L. REV. 487, 488-89 (1990) (footnote omitted).

⁴⁸ See *Kindergartners Count, Inc.*, 2003 U.S. Dist. LEXIS 4212 at 6.

⁴⁹ See *id.*

⁵⁰ See *id.* at 9.

⁵¹ See *id.* at 11.

was obligated to “hold in confidence all information obtained in the course of providing consulting services.”⁵²

1. *Claims*

TPA gave formal notice of intent to terminate the Partnership Agreement to KCI.⁵³ TPA’s reasons for terminating the partnership were business problems:

The production problems, delivery intervals and recent discussion with your managers regarding intended price increases have led us to conclude that if the TPA decides to continue to do business with KCI, it should be in a different format.⁵⁴

Additionally, DeMoulin gave notice to KCI of his intent to terminate the Consulting Agreement.⁵⁵ Subsequently, DeMoulin executed a Contract Agreement with TPA, in which “he agreed to ‘research and develop a complete personalized reader program for kindergarten children specifically for the TPA to include a personalized Reader [and] a Curriculum Planner for Teachers.’”⁵⁶ “No one from KCI was advised of the TPA owned personalized reader until it was approved by TPA”⁵⁷ KCI sued TPA claiming breach of contract (the Partnership Agreement) and breach of fiduciary duty, and KCI sued DeMoulin claiming breach of contract (the Consulting Agreement) and breach of

⁵² *Id.* (quoting the Confidentiality provision of the Consulting Agreement).

⁵³ *See id.* at 13-14.

⁵⁴ *Id.* at 14. In fact, TPA and KCI entered into a Service Agreement after the partnership was terminated. “The Service Agreement was characterized as a ‘customer-vendor/supplier relationship,’ with TPA as customer and KCI as the vendor/supplier.” *Id.* at 15-16.

⁵⁵ *Id.* at 14. DeMoulin advised KCI of his intent to terminate the Consulting Agreement, *except* for portions that related to payments to him. *Id.* at 15. However, two weeks later, DeMoulin “requested to keep his Consulting Agreement with KCI in place, stating that he had acted on bad advice from his lawyer, who was an ‘idiot.’” *Id.*

⁵⁶ *Id.* at 15. (quoting the Contract Agreement between DeMoulin and TPA).

⁵⁷ *Id.* at 16. TPA approved its reader nine months after TPA gave notice of its intent to terminate the KCI-TPA Partnership Agreement.

fiduciary duty. DeMoulin counterclaimed alleging defamation.⁵⁸ This paper will only examine the breach of contract claims regarding the KCI-TPA Partnership Agreement.

2. *Ruling and Reasoning*

The District Court, applying Kansas law,⁵⁹ did not prevent defendant TPA from terminating the Partnership Agreement.⁶⁰ KCI alleged TPA breached the termination clause, TPA's implied duty of good faith and fair dealing, and the "related product" provision.⁶¹ The termination provision of the Partnership Agreement stated: "The partnership can be dissolved with written notification of either party to the other within 60 written days of July 30 each year."⁶² The parties contended that there was ambiguity regarding the termination date and that the clause was ambiguous as to whether termination could be done without cause.⁶³ The court recalled its previous ruling that there was no ambiguity regarding the termination date, and the court ruled that "the termination clause includes an unambiguous reservation by both parties of discretion to terminate the agreement."⁶⁴ KCI tried to submit an affidavit of one of its officers that stated that he believed the Partnership Agreement "could only be terminated for cause in

⁵⁸ *Id.* at 47. This counterclaim was based on a KCI officer's statements to DeMoulin's boss that DeMoulin was a plagiarist. DeMoulin asserted that a finding of no copyright infringement means that no plagiarism occurred. *Id.* The court disagreed. *See id.* at 49.

⁵⁹ The parties agreed that Kansas law applied to contractual interpretation. *Id.* at 18-19. On the fiduciary duty claims, the court applied the Uniform Partnership Act and common law. *See id.* at 16-18, 30, 34.

⁶⁰ *Id.* at 49. The case was on motion for summary judgment. The opinion denied the parties' motions. *Id.* at 2-3.

⁶¹ *Id.* at 18, 21-29. KCI also alleged another breach of contract claim, TPA's "failure to distribute." However, KCI did not include this claim in the Pretrial Order, although TPA included the issue in its affirmative defenses. The court held that KCI waived this claim. *See id.* at 28-30.

⁶² *Id.* at 21.

⁶³ *Id.*

⁶⁴ *Id.* at 22.

order to secure the long term nature of the parties' relationship."⁶⁵ However, applying established contract law principles, the court excluded the extrinsic evidence. "Such evidence is inadmissible given the Court's finding that the termination clause is unambiguous."⁶⁶ Since there was no express requirement of cause to terminate the Partnership Agreement, the termination clause would not prevent TPA from terminating the partnership.

KCI alleged a breach of TPA's implied duty of good faith and fair dealing, "which Kansas courts have followed the trend of implying in almost every contract."⁶⁷ The court ruled that "[t]he concept of good faith becomes irrelevant in the interpretation of a contractual provision which grants 'uncontrolled discretion' to one of the parties. Because the termination clause gave the parties the right to terminate the Partnership Agreement without cause, KCI is precluded from contending that it had a reasonable expectation of any implied protection with respect to termination."⁶⁸ TPA would not be held to owe a duty of good faith and fair dealing to KCI with regard to termination, so no such duty prevented TPA from terminating the partnership as it wished.⁶⁹

KCI also alleged TPA breached the "related product" provision of the Partnership Agreement which stated:

⁶⁵ *Id.* at 22, note 30.

⁶⁶ *Id.*

⁶⁷ *Id.* at 23 (footnote omitted).

⁶⁸ *Id.* (footnote omitted).

⁶⁹ However, the court agreed with KCI that the implied duty of good faith and fair dealing remained in effect as to the provisions of the contract relating to performance. *Id.* at 24. "KCI contends that TPA breached its implied duty by 'secretly' developing [its own program] and contracting with DeMoulin prior to termination of the Partnership Agreement." *Id.* The court held that that issue remained a question of fact to be decided by the jury. *Id.*

KCI is the owner and copyright [sic] holder of the “I Like Me!” reader and teachers guide. Any “I Like Me!” related product or service created by Pioneers will be approved by KCI prior to promotion or distribution. . . . KCI will be responsible for the development of any new products under the “I Like Me!” program.⁷⁰

KCI asserted that TPA breached the contract “by developing and promoting a competing product which was ‘related’ to the ILM program without informing KCI of its intentions and efforts or seeking KCI’s consent as required by the Partnership Agreement.”⁷¹ TPA developed a personalized reader and program called “A Book About Me.”⁷² The court decided the issues of whether the “related product” provision was ambiguous, whether TPA’s own program was a “related product or service” to the ILM program, and at what time KCI’s approval was required.⁷³ The court held that the term “related product”, as used in the Partnership Agreement was ambiguous, and it held that extrinsic evidence was admissible to determine the parties’ intent.⁷⁴ Additionally, the court held that whether TPA’s own program qualified as a related product of the ILM program was ambiguous. The court decided it was unclear whether TPA’s program was a “new product” for whose “development” KCI was responsible. Further, the court held that there were “issues of material fact concerning TPA’s progress and intent with respect to the program.”⁷⁵

⁷⁰ *Id.* at 25.

⁷¹ *Id.*

⁷² *See id.* at 13. TPA developed “A Book About Me” with DeMoulin at a time when DeMoulin was still bound by his Consulting Agreement with KCI and when TPA was still bound by its Partnership Agreement with KCI.

⁷³ *Id.* at 26.

⁷⁴ *Id.* at 27.

⁷⁵ *Id.* at 28.

3. *Principles*

Kindergartners Count applied basic principles of contract law to decide whether to prevent termination and to interpret a “related product” provision. In summary, if a contract unambiguously allows termination without cause, a party cannot introduce evidence of a cause requirement. If a party can terminate the agreement without cause, that party does not owe a duty of good faith and fair dealing to the other party. Whether a party breached an implied duty of good faith and fair dealing by secretly developing a competing product and contracting with the other party’s independent contractor prior to termination of the Partnership Agreement is a question of fact for the jury. Since the term “related product” is ambiguous, it is a question of material fact whether one party’s program was a related product or service to the partnership’s program, requiring the other party’s approval.

C. Termination Due to Failure to Generate Sufficient Income or Revenue

In *Data Marketing Co. of Virginia v. United States*, a JV parent who was party to two JVAs terminated both of them due to failure of one or both of the related JVs to generate revenue.⁷⁶ Plaintiff Data Marketing Co. of Virginia (“DMC”), Intessera Technologies Group, Inc. (“ITG”), and defendant National Technology Information Service (“NTIS”) entered into one JVA;⁷⁷ Plaintiff Standard Development Association, Inc. (“SDA”) and defendant NTIS entered into another one. The same man, Barry Nelsen, owned and operated DMC, ITG’s parent, and SDA. NTIS is an agency within

⁷⁶ See *Data Marketing Co. of Virginia v. United States*, No. 00-595C, 2003 U.S. Claims LEXIS 68 (Ct. Fed. Cl. Mar. 21, 2003).

⁷⁷ The original parties were DMC, Western Technologies Communications, Inc. (“WTCI”), and NTIS. ITG was a wholly-owned subsidiary of WTCI which took WTCI’s place in the JV. ITG had developed the “SpecFinder” program for WTCI. *Id.* at 11.

the U.S. Department of Commerce. The purpose of the JVs was “to provide the public with procurement-related data from the Department of Defense.”⁷⁸ The subject of the DMC-ITG-NTIS JVA was entitled Technical Data Package Management Information System (“TDPMIS”);⁷⁹ the subject of the SDA-NTIS JVA was named Industry Standards Repository and Distribution Network (“ISRDN”).⁸⁰ The Department of Defense (“DOD”) supported NTIS’ efforts, as well as other approaches; DOD provided NTIS with initial start-up funding for TDPMIS.⁸¹

1. *Claims*

NTIS sent termination letters to DMC, ITG, and SDA.⁸² NTIS attributed the terminations to lack of revenue and changed circumstances. “Despite positive reviews of

⁷⁸ *Id.* at 1.

⁷⁹ NTIS was obligated to provide data, standards and drawings; ITG was responsible for software development and provision and for telecommunications support; DCM was responsible for marketing, planning and consulting with respect to TDPMIS. *See id.* at 12-13.

⁸⁰ NTIS was required to provide facilities and technical expertise to store and access the ISRDN database; SDA was responsible for making contact with representatives of Standard Development Organizations (“SDOs”), from whom NTIS obtained non-governmental standards which would be posted on SpecFinder, for establishing distribution agreements, and for providing customer relations with SDO representatives. *See id.* at 6-7, 9-10.

⁸¹ *See id.* at 5-6.

⁸² The termination clause in Paragraph 5.2 provided:

“This agreement may be terminated:

- (a) by any Party upon at least five days’ [sic] advance written notice to the other Parties, given at any time prior to the commencement of the Operational Phase;
- (b) by any Party, upon at least 180 days’ [sic] advance written notice to the other Parties, given at any time following commencement of the Operational Phase;
- (c) by any Party, immediately upon written notice to the other Parties, if either of the other Parties shall have failed to perform any of its material covenants or obligations under this Agreement, or if any of the representations or warranties of the other in this Agreement fail to be true and correct in any material respect, and such failure shall have continued for a period of thirty days after written notice thereof given by the terminating Party.” *Id.* at 15-16.

TDPMIS, NTIS ultimately decided that it could not continue to support a project that was not creating revenue.”⁸³ An NTIS officer stated that “it was decided that [NTIS] would terminate because there was no chance of [TDPMIS] becoming a commercially-viable program.”⁸⁴ NTIS’ termination letter to DMC and ITG indicated an intent to terminate in thirty days and stated that “the environment for delivering procurement-related technical data has changed dramatically and many of the original assumptions are simply no longer valid.”⁸⁵ The letter also made provision for the non-terminating party to continue under the JVA, as authorized by that agreement, should it want to continue the project.⁸⁶ In ITG’s response to NTIS’ termination letter, ITG contended that the JVA required a longer termination period and expressed concern about “DOD’s other programs offering the same information ‘which has resulted in establishing a competitive role for the TDPMIS project.’”⁸⁷

DMC and SDA sued the United States. DMC argued that “DOD breached DMC’s [JVA] by (a) supporting Procurement Gateway to compete with TDPMIS, (b) intentionally withholding data feeds from DOD to TDPMIS, and (c) directing NTIS to terminate the DMC [JVA].”⁸⁸ DMC also claimed that NTIS breached the JVA.⁸⁹ DMC argued that DOD and NTIS breached fiduciary duties owed DMC.⁹⁰ Finally, DMC made

⁸³ *Id.* at 26.

⁸⁴ *Id.* at 28. NTIS was required by legislation to be “substantially self-sustaining.” *Id.*

⁸⁵ *Id.*

⁸⁶ *Id.* at 29. Section 5.3 of the DMC-ITG-NTIS JVA contained the Continuation clause. *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.* at 37.

⁸⁹ *Id.* at 57.

⁹⁰ *Id.* at 59.

third-party beneficiary claims.⁹¹ SDA claimed that NTIS breached the JVA and breached its fiduciary duty. DMC demanded “loss of profits, costs incurred and misappropriation of intellectual property in the amount of [\$20,774,129].”⁹² SDA demanded “loss of profits and costs incurred in the amount of [\$7,639,442].”⁹³ This paper will only examine DMC’s breach of contract claim against DOD, DMC’s breach of fiduciary duty claims against DOD and NTIS, and SDA’s breach of contract claim against NTIS.

2. *Ruling and Reasoning*

The United States Court of Federal Claims did not stand in the way of defendant’s terminating the JVAs: The court granted defendant’s motion for summary judgment and denied plaintiffs’ motion for summary judgment.⁹⁴ As for DMC’s breach of contract claim against DOD, the court ruled that DOD was not a party to the DMC JV, so it could not be liable for breaching an agreement to which it was not a party.⁹⁵

It is well-settled that in order to sue the government for breach of contract the contractor must show that it is in privity with the breaching party. In addition, it is equally well-settled that a contract with one agency of the United States is not a contract with any other agency of the United States.⁹⁶ Nevertheless, the court ruled in the alternative that, even if DOD were deemed to be a party to the DMC JVA, DOD did not breach the JVA.⁹⁷

⁹¹ *Id.* at 60-61.

⁹² *Id.* at 35. The court entered summary judgment against DMC on the intellectual property claim because it considered DMC to have conceded that claim. *Id.* at 35, note 10.

⁹³ *Id.*

⁹⁴ *Id.* at 70.

⁹⁵ *See id.* at 37.

⁹⁶ *Id.* at 37-38 (citations omitted).

⁹⁷ *Id.* at 42.

First, DOD did not breach any agreement by supporting Procurement Gateway to compete with TDPMIS.

An examination of the [JVA] reveals that the government did not promise DMC that it would not invest in or support other government operated web-based procurement information systems. To the contrary, . . . the government made it clear from the outset that DOD was developing and supporting other web-based procurement information systems. Absent an agreement from DOD not to support other web-based systems, DMC's contention that DOD breached the DMC [JVA] is unfounded.⁹⁸

Second, DOD did not breach the JVA by failing to provide data feeds to NTIS. The JVA includes an express "Limitation of Liability" clause regarding each party's obligations.⁹⁹ The clause states, in all capital letters: "NEITHER ITG NOR NTIS SHALL HAVE ANY LIABILITY OR OBLIGATION WHATSOEVER FOR ANY FAILURE, OUTAGE OR INTERRUPTION OF THE ITG SYSTEM OR NTIS SYSTEM OR THE DATA CIRCUITS ON WHICH THE . . . DATA IS TRANSMITTED" ¹⁰⁰ The court held that "the contract precludes a finding of liability for any failure in connection with the receipt of data. Because DMC's claim rests on its contention that DOD interrupted the data feeds, its claim is barred by the contract."¹⁰¹

Third, DOD did not breach the JVA by impermissibly directing NTIS to terminate TDPMIS in an effort to deprive DMC of its JV profits.¹⁰² The court started out by clarifying semantics: "The government did not terminate TDPMIS, it withdrew its

⁹⁸ *Id.* at 42-43.

⁹⁹ *Id.* at 46.

¹⁰⁰ *Id.* at 47 (quoting DCM/ITG/NTIS Joint Venture Agreement 8).

¹⁰¹ *Id.* (footnote omitted).

¹⁰² *Id.* at 51.

support from the program.”¹⁰³ NTIS allowed DMC to continue under the JVA should it wish to carry on the project,¹⁰⁴ but the JVA did give each of the parties the right to withdraw from TDPMIS.¹⁰⁵ All the party had to do was provide notice. “DOD had no obligation to support TDPMIS for any period of time. Since it is not disputed that the government gave DMC the requisite notice, it fulfilled its obligations under the [JVA].”¹⁰⁶ DOD did not have to discuss its decision to withdraw in advance of giving notice, and nothing in the agreement required cooperation.¹⁰⁷ The termination clause permitted a party to abandon its responsibilities for any reason. Nevertheless, “to the extent there is any doubt that the government’s motives in deciding to withdraw from the [JV] was [sic] to harm DMC, the reasons provided by . . . the head of NTIS . . . remove any doubt. . . . [The NTIS head] justified his decision to withdraw from TDPMIS on the grounds that TDPMIS was not financially viable.”¹⁰⁸

The court dismissed DMC’s breach of fiduciary duty claims against DOD and NTIS. DMC claimed that the government breached its fiduciary duty to DMC under the JVA by failing to disclose its commitment to Procurement Gateway and to be entirely loyal to the JVs’ purpose.¹⁰⁹

Ordinarily, joint venturers are considered “partners” and as “partners” owe each other certain fiduciary duties. [However], the DMC [JVA] expressly states that the joint venturers are not partners: “Nothing in this Agreement

¹⁰³ *Id.* at 52.

¹⁰⁴ *See supra* note 86 and accompanying text.

¹⁰⁵ *Data Marketing Co.*, 2003 U.S. Claims LEXIS 68 at 52. The court noted that this right to withdraw marked the difference between the JVA and a contract by the government for goods and services which is subject to traditional government contract principles. *Id.*

¹⁰⁶ *Id.* at 54 (footnotes omitted).

¹⁰⁷ *Id.* at 54, note 18.

¹⁰⁸ *Id.* at 55.

¹⁰⁹ *Id.* at 59.

constitutes or shall be construed to constitute any of the Parties as partners, and none of the Parties shall have any power or authority to bind the other or others in any respect.” . . . [T]he parties altered the normal joint venture obligations and provided that they would not owe any fiduciary duty to each other.¹¹⁰

Because of the plain language of the contract, the court could not read partnership or fiduciary obligations into the JVA and therefore held that neither NTIS nor DOD breached any fiduciary duty owed DMC.

As for SDA’s breach of contract claim against NTIS, the court held that NTIS did not breach the termination provisions of the SDA JVA.¹¹¹ NTIS notified the Standard Development Organizations (“SDOs”),¹¹² with whom NTIS had licensing agreements, that it was terminating its participation in ISRDN.¹¹³ SDA argues that, rather than terminating the license agreements, NTIS should have transferred them to SDA, and SDA argued that its agreement with NTIS prohibited NTIS from taking “unilateral action that might undermine ISRDN, including notifying SDOs of NTIS’ decision to withdraw from ISRDN.”¹¹⁴ Additionally, SDA alleged that NTIS’ actions prevented SDA from informing the SDOs of NTIS’ successor to take over the database and web page; SDA claimed that it was entitled to cooperation from NTIS in implementing a succession plan.¹¹⁵ In response, the government did not dispute that SDA informed NTIS of its desire to continue ISRDN, but the government argued that SDA never identified, within

¹¹⁰ *Id.* at 59-60 (quoting DCM/ITG/NTIS Joint Venture Agreement 8) (citations omitted).

¹¹¹ *Id.* at 65.

¹¹² *See supra* note 80.

¹¹³ *Data Marketing Co.*, 2003 U.S. Claims LEXIS 68 at 65.

¹¹⁴ *Id.* at 65-66.

¹¹⁵ *Id.* at 66.

sixty days after notice of withdrawal, a designated party who would succeed NTIS.¹¹⁶ The court agreed with the government that SDA was obligated to identify a party with whom NTIS could work during the 120 days provided for a transition.¹¹⁷ “Without a designation, the government argues that NTIS had no obligation to continue to assist SDA in a transition and was free to serve notice . . . on the SDOs of NTIS’ intention of terminating its licensing agreements with them.”¹¹⁸

3. *Principles*

Data Marketing Co. applied basic contract law principles to decide whether to prevent termination of the JVA and of related licenses and to interpret contract clauses dealing with termination, withdrawal, continuation, and limitation of liability, among others. In summary, in the case of a JV with the government, the other party must be in privity with the breaching party in order to sue. If one party makes it clear from the outset that it is developing and supporting IP projects that compete with the JV, the other party cannot sue absent an agreement that the first party would not support competing projects. If the parties to the JVA provided that they would not owe fiduciary duties to each other, then a party has not breached a fiduciary duty by failing to disclose its commitment to a competing project. Where continuation under a JVA is allowed, a party must comply with the transition clause in order to argue that the other party is obligated to assist the first party with transition. One JV party who has license agreements with a

¹¹⁶ *Id.* Section 6(d) of the SDA JVA states: “In the event that either party withdraws from the [JV], the withdrawing party will cooperate in the transition of its respective responsibilities to a designated party. Transition will be accomplished within 120 days after 60 days written notice.” *Id.*

¹¹⁷ *Id.* at 67.

¹¹⁸ *Id.* at 66-67.

third party may terminate those licenses, rather than transferring them to the second JV party, if the second party has not designated a successor to the first party in compliance with the transition clause.

IV. Post-Termination

Upon termination of an intellectual property JV, what happens to the IP, both that of the parents and that of the JV? The parents have many contractual options to provide for the IP upon termination. A parent's IP might be governed by agreements separate from the JVA, for example, license agreements between the parent and a third party or between the parent and the JV. A parent can either terminate its licenses to third parties, or it can transfer them to the other JV parent.¹¹⁹ As for a parent's licenses to the JV, the parent can terminate the licenses so that the IP rights revert to the parent, or the IP rights could continue with the JV.¹²⁰ However, the JVA determines the destination of the JV's IP, which means the parties should have contracted in advance to allocate IP created during the course of the JV project. The JV's IP might be in the form of copyrights, patents, or licenses; or the value of the IP might be represented in the goodwill or equity of the JV.

The JVA should specifically allocate rights to the JV's IP when the IP is not easily divisible. Theatrical collaboration JVAs contain detailed language regarding copyright ownership upon termination of the collaboration.¹²¹ The contract language of a

¹¹⁹ See, e.g., *supra* text accompanying note 114 (regarding NTIS' licenses to the SDOs).

¹²⁰ See, e.g., *supra* note 86 and accompanying text (regarding continuation of TDPMIS).

¹²¹ See M. Brannon Wiles, *Do Theatrical Collaboration Agreements Create a Joint Venture?*, 25 COLUM. J.L. & ARTS 219, 227 (2002) (analyzing key clauses of the Form of Collaboration Agreement used by the Dramatists Guild, Inc.).

typical collaboration agreement states that the collaboration will not be deemed a “joint work.”¹²² This is a way to contract out of the statutory default of co-ownership of copyright in the work which gives the parents an undivided interest in the whole work.¹²³ Rather, copyright ownership reverts to the individual contributors upon termination.¹²⁴ “[T]he parties may choose to prohibit individual collaborators from using the elements [of the work that are not readily divisible], or they may provide that all collaborators may use the non-divisible elements freely.”¹²⁵ However the parents wish to allocate the IP, they must do so in advance in the JVA.

When the value of the IP is represented in the goodwill or equity of the JV, the parents can secure that value upon termination of the JVA. One parent can buy out the other parent’s interest; both venturers can sell their interest to a third party; or the JV could liquidate and distribute its assets to the parents.¹²⁶ In the case of one parent buying out the other parent’s interest, the parents could submit bids to each other until one ends up being the highest bidder.¹²⁷ If there are many parents, they could hold an auction in which the partners bid for the offered interest.¹²⁸ An agreement could provide that “a defined ‘nondefaulting party’ [would] have greater rights than a defined ‘defaulting party.’ For example, if a party becomes a defaulting party because it has gone into bankruptcy or has materially breached its covenants, then the nondefaulting party might have an option to purchase the defaulting party’s shares at a formula price”¹²⁹ The

¹²² See *id.*

¹²³ See *id.* See generally 17 U.S.C.S. 201(a)(2003).

¹²⁴ Wiles, *supra* note 121, at 227.

¹²⁵ *Id.*

¹²⁶ See Hooton, *supra* note 17, at 1028.

¹²⁷ *Id.* at 1029.

¹²⁸ WOLF, *supra* note 12, at 259.

¹²⁹ Hooton, *supra* note 17, at 1028.

JVA should specify the mechanism by which the parents can secure the value of the JV's IP and should specify any related conditions.

Conclusion

JV parents must draft with an eye towards hostile termination and must account for post-termination issues. If the parties have not planned for changed circumstances or expectations in their JVA, the courts will interpret the agreement according to established contract interpretation principles. Courts more often than not will allow the parent who wants to terminate the JVA to do so, with little protection to the parent who wants to continue the JV. This does not lead to the best disposition of the IP involved. The parties should draft the JVA to provide for the JV's IP upon termination, just in case one party wants to continue the JV after the other party terminates the JVA.