

Good Deals Gone Bad: Joint Ventures

10 Major Joint Venture Pitfalls

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Today's Speakers

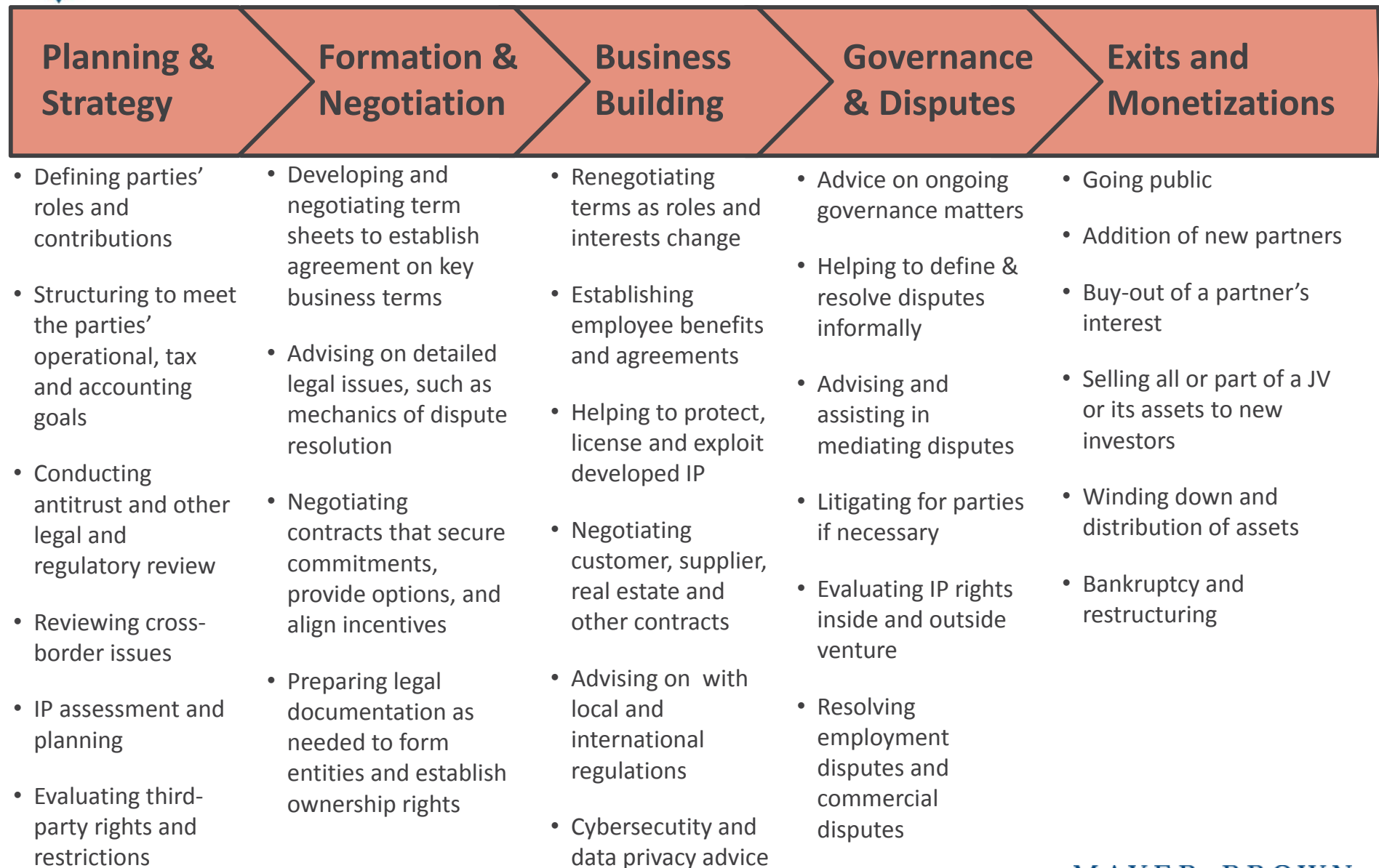


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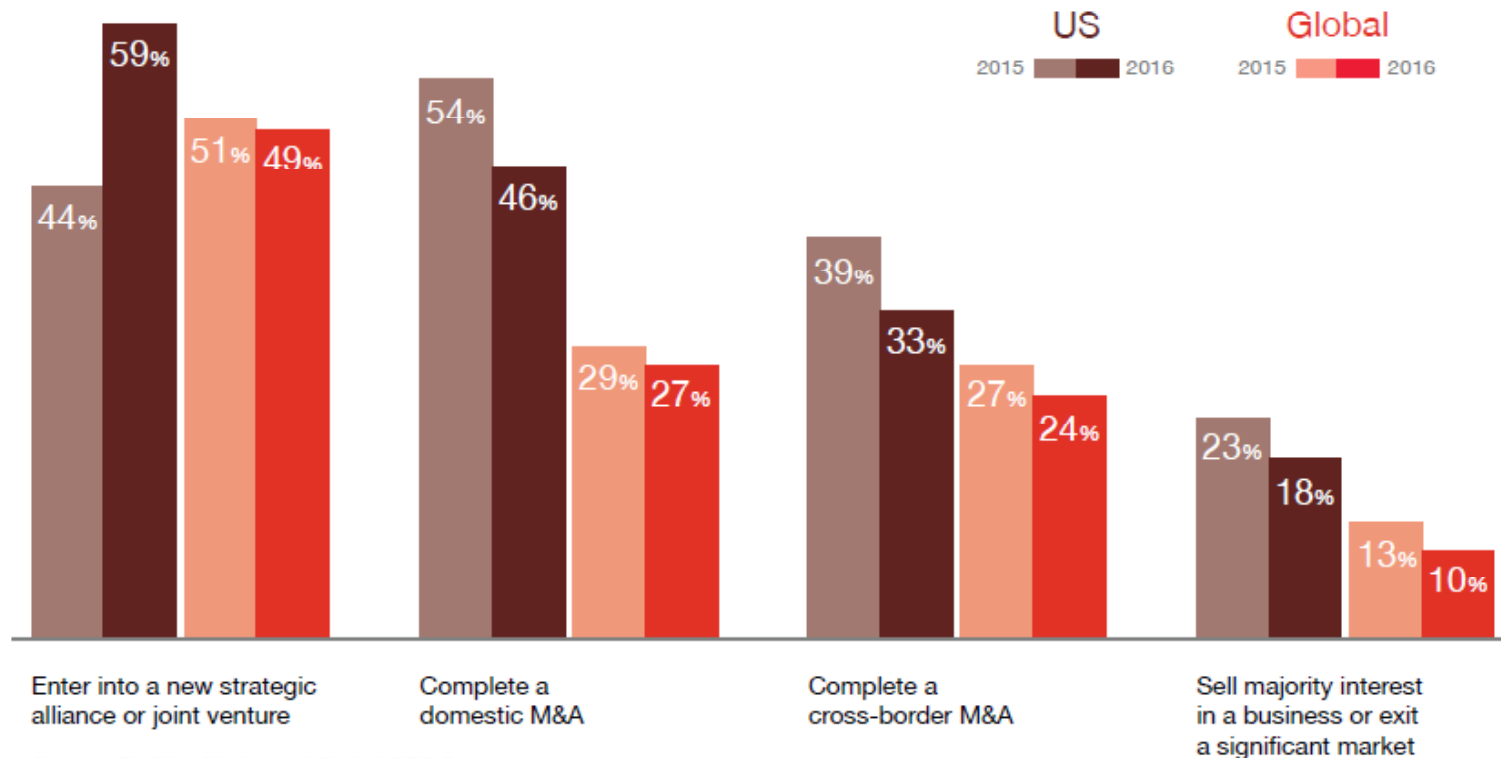


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First in a Series of Webinars on Joint Ventures



Introduction to Joint Ventures



- Quick stats:

- More than half of CEO's surveyed plan to enter into a joint venture over the next year
- More than 1,500 JV deals completed annually in the past 10 years
- 10% percent of JV deals involve large JVs (with an initial value of more than US\$250 million)

1. An Absence of Compatibility and Common Purpose with the JV Partner

- Pitfall – choosing the wrong partner
 - Incompatible cultures and/or objectives can prove highly problematic or even fatal to joint ventures.
 - Requires the unnecessary expenditure of time, effort and resources, and, worse, could undermine the joint venture itself and even cause irreparable harm to reputation and business more generally.
 - Risks range from business conduct, compliance and corruption issues to product and service liability problems. In the international context, local legal, political, social and economic variables could also be potential risk factors in establishing a common vision/mission.
- Example
 - The “Yemeni Partner”

1. An Absence of Compatibility and Common Purpose with the JV Partner (Cont'd)

- Best practice solutions
 - Identify a JV Partner with aligned business goals, a compatible organizational mindset and with qualities that will maximize the success of the joint venture.
 - Avoid evaluating and entering a venture in a rush or in isolation. Undertake a thorough and comprehensive risk/reward profile of the venture, the partner and the context.
 - Conduct thorough due diligence on potential JV partners (including ultimate managers). Fully understand the partner's past practices, incentives and objectives (in addition to your own).
 - Identify and investigate key variables of success for the JV (e.g., capital, products, relationships, assets, management, market position, licenses and permits) even before negotiation commences.
 - Understand and work with cultural differences – they need not be your enemy.
 - Establish a relationship of trust and transparency.

2. Becoming Bound to a JV Partner Before Formalizing Documentation

- Pitfall – false start
 - Disputes arise with some frequency when parties start working together as if they were venture partners, but have not finalized the joint venture agreement.
 - Depending on the jurisdiction, parties can become bound to a joint venture by taking certain steps – investing time and money, marketing the venture, combining assets – even in the face of express disclaimers.
- Example
 - The Double E Pipeline (Energy Transfer Partners v. Enterprise Products Partners).

2. Becoming Bound to a JV Partner Before Formalizing Documentation (Cont'd)

- Best practice solutions
 - State clearly in documents whether parties intend to form a joint venture. If steps must be completed before venture is formally initiated, make those steps conditions precedent to venture formation.
 - For additional comfort, if no joint venture is intended, each party should waive any right to assert a claim based on the existence of a joint venture or partnership. Parties may want to disclaim fiduciary obligations as well (but not always respected by courts).
 - Avoid public marketing or statements indicating that a joint venture has been formed. If you need to test a market in advance of venture formation, agreements should make clear that this is condition to formation.
 - Be wary of agreements to agree to form a joint venture. Such agreements can sometimes become enforceable, and attempts to renegotiate the agreed-upon terms can be deemed bad faith.

3. Failing to Adequately Demarcate the Scope of the Joint Venture

- Pitfall – competition claims
 - Disputes commonly arise where one JV party is accused of misappropriating a joint venture opportunity. This typically occurs because the parties have not specified the scope of the venture with adequate specificity.
 - This problem is particularly problematic where one or both parties are already competing in a particular market, and one party views the joint venture narrowly, while the other views the venture more broadly.
- Example
 - Pharmaceuticals company dispute; *In re Mobileactive Media*

3. Failing to Adequately Demarcate the Scope of the Joint Venture (Cont'd)

- Best practice solutions
 - Establish scope of joint venture in agreements – limit by customer market, geographic market, specific product or opportunity.
 - Even absent a non-compete obligation, partners and venturers will have fiduciary duty of loyalty not to take a venture/partnership opportunity.
 - It is better to start with a narrow definition and broaden than to define broadly. It is very difficult to agree on areas that the partners may compete against the venture after the venture is in operation.
 - Make sure that all provisions – scope, non-compete, license rights – are aligned. Conflicting provisions can create opportunities for disagreements and litigation.

4. Failing to Anticipate or Address Potential Problems in the JV Documents

- Pitfall – not adequately preparing for challenges or contingencies
 - The failure to provide for contractual and/or structural protections in relation to potential problems with the JV or to points of contention with the JV partner is surprisingly common
 - This often leads to a serious partnership dispute and/or the breakdown of the JV itself.
- Example
 - The Inbound Chinese Client

4. Failing to Anticipate or Address Potential Problems in the JV Documents (Cont'd)

- Best practice solutions

- Negotiate documentation with a shared understanding of the JV's structure, management and operations.
- Do not be reluctant to anticipate and address possible areas of disagreement and contingencies.
- Institute performance monitoring metrics and mechanisms – avoid the build up of problems.
- Institute appropriate conciliation and resolution mechanisms.
- Create clear policies and guidelines. Consider local legal issues in cross-border situations.
- Establish thoughtful legal strategies to manage various business outcomes AND thoughtful business strategies to handle various legal outcomes.

5. Failing to Draft or Abide by Governance Obligations

- Pitfall – disputes about control and governance rights in JV decisions
 - Most JV agreements set forth processes for governing the venture, including committees with authority, and processes that should be followed.
 - In practice, however, one party may take a more active role in management, and formal processes may not be followed. Eventually, complaints arise concerning the governance of the operations.
- Example
 - Pharmaceutical joint venture; utility company.

5. Failing to Draft or Abide by Governance Obligations (Cont'd)

- Best practice solutions
 - Draft clear governance provisions in JV or Operating Agreement, identifying levels of authority for managers and decisions that must be made by management committee of JV.
 - Consider what reporting requirements to impose on JV management to JV committees. Absent reporting, decisions may happen without the knowledge of committees.
 - Ensure company representatives to the committees are engaged and vigilant in reviewing activities. Delays in raising issues will often result in lost leverage and rights with respect to decisions.
 - Consider remedies for governance disputes short of arbitration or litigation.

6. Failing to Prepare and Protect Your People

- Pitfall – overlooking the people risk
 - For a variety of reasons, parties often neglect to contemplate and institute adequate contractual and structural protections for the people contributed to, working in or connected with a joint venture.
- Example
 - UAE example (public misconduct) / China example (theft)

6. Failing to Prepare and Protect Your People (Cont'd)

- Best practice solutions
 - Train JV personnel on (i) relevant local laws and customs, (ii) the legal and compliance issues relating to the JV's finances and operations (iii) regular reporting to management.
 - Institute a strong compliance policy and program.
 - Provide indemnification and directors and officers liability Insurance (D&O) at the JV and parent level.
 - Enter into separate, non-competition, non-solicitation agreements where possible.

7. Failing to Protect Your Brand and IP

- Pitfall – putting your name and intellectual property at risk
 - Some of the most significant liabilities facing joint venture partners are in the area of brand and intellectual property risk.
 - This is particularly true in the international context, where local partners (and governments) could be seeking to benefit at the expense of their multinational partners.
- Example
 - The Pastry Affair

7. Failing to Protect Your Brand and IP (Cont'd)

- Best practice solutions
 - Conduct IP search and register trademarks and domain names (prior to the JV).
 - Understand and seek maximum IP protections under local law.
 - Clearly and comprehensively delineate what is in/out of the JV.
 - Insist on internal controls, regular reporting, audit rights and appropriate representation on the management and/or board.
 - Create ongoing monitoring mechanisms and response levers.

8. Failing to Take Stock of the Regulatory Risks

- Pitfall – inadequate focus on the increasingly complex compliance picture
 - Failure to timely identify issues relating to foreign investment regulation, anti-corruption, antitrust and other regulatory matters may pose significant risk both to the JV and its partners.
- Example
 - The Brazilian Incident

8. Failing to Take Stock of the Regulatory Risks (Cont'd)

- Best practice solutions
 - Conduct preliminary study of regulatory issues before finalizing any preliminary documentation and include any regulatory requirements in the JV project structure and timeline.
 - Conduct thorough investigation of foreign investment laws (exchange controls, defense, sensitive lands, culture, etc.).
 - Incorporate comprehensive compliance provisions into the JV documentation.
 - For international joint ventures, do not focus on U.S. compliance to the exclusion of local country rules and regulations.

9. Failing to Adequately Prepare for Exit or Separation

- Pitfall – potential for costly litigation or exposure to unwanted liability
 - JVs are risky by nature (a significant percentage fail) and many others outlive their strategic utility.
 - Exit must be a contemplated reality of each JV, no matter the exuberance of entry or the promise of profit.
- Example
 - Venezuela Example

9. Failing to Adequately Prepare for Exit or Separation (Cont'd)

- Best practice solutions
 - Carefully consider the length of the JV and prepare for an organized unwinding of operations upon the JV's expiration or termination.
 - Consider setting a modifiable expiration date for the JV and minimize the leverage of the JV partner to deter or delay a desired exit.
 - Determine and document trigger events for the JV's termination (such as IP, loss of key business, failure to abide by an agreed business strategy), and be explicit about termination rights and obligations.
 - Put into place clear termination mechanisms - note that termination rights do not have to be reciprocal.
 - Do not rely exclusively on legal terms; consider what business and other levers could be brought to bear.

10. Failing to Pay Close Attention to Dispute Resolution Provisions

- Pitfall – difficulty in resolving disputes, including increased costs and uncertainty
 - Dispute resolution provisions are often given little attention. Parties will agree to arbitrate a dispute according to a set of arbitral rules.
 - Several issues arise:
 - (1) Whether resolution through arbitration is the most efficient mechanism depends on nature of dispute and jurisdictions involved;
 - (2) Mechanisms are needed for resolution before formal dispute resolution; otherwise it becomes difficult to resolve differences.
 - (3) Inadequate consideration to the specific process to be followed may result in more costly or inefficient dispute resolution than desired.
- Example
 - Health care and Turkish venture disputes

10. Failing to Pay Close Attention to Dispute Resolution Provisions (Cont'd)

- Best practice solutions
 - Consider including escalation process for disputes and informal resolution processes.
 - Dispute resolution mechanisms (e.g., litigation/arbitration, arbitral organization), location, language , number of arbitrators) should be carefully considered and specified.
 - Consider the types and size of disputes that may arise, and tailor dispute resolution mechanism accordingly (e.g., small disputes to be submitted under expedited process; larger disputes to include enhanced processes).
 - Evaluate enforceability of award in parties' jurisdictions, and extent of appellate rights to be afforded parties.

Thank You

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