TOP TIPS FOR SUCCESSFUL INTERNATIONAL JOINT VENTURES

Speakers:

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Setting up a JV in the Land of Hypothetica...

You are the General Counsel of Nimble Co., a rapidly growing consumer products company. Nimble Co is based in the U.S. and, up until now, all of its sales have been in North America. Its product offering emphasizes locally-sourced ingredients in high quality personal soaps and cleansers.

Nimble Co has just hired a new Vice President of Sales whose mission is to develop international sales while staying true to its core values of local sourcing and high quality.

You were just about to head out a bit early on a Friday afternoon to get a jump on traffic when the VP of Sales, Ian Pushy, bursts into your office and announces that he has found the perfect joint venture partner in Hypothetica to help launch the Nimble brand in all of Asia Pacific – Local Co.

Setting up a JV in the Land of Hypothetica (continued)...

He outlines the terms they have already discussed:

- **50/50 stock ownership with Nimble having a tiebreaking vote at the board level.**
- **Local selects management with Nimble having a veto right (exercise of which is reasonable) over the CEO of the JV.**
- **JV is exclusive producer and distributor of Nimble-branded products in Asia Pacific.**

He asks whether you can have someone draft a joint venture agreement asap so that they can sign it next week. He explains that you don't need to flyspeck the deal because Local is a company owned by one of the wealthiest families in Hypothetica, so we can feel comfortable we're dealing with a reputable company.

What is your response?

50/50 Stock Ownership with Nimble Having a Tiebreaking Vote at the Board Level

- Data suggests that 50/50 joint ventures work better than others when the relative contributions of the joint venture "partners" are equivalent.

- If the relationship is to be 50/50, there must be careful consideration of and drafting to the rights of the parties and the impasse provisions (in order to break deadlocks). The agreement could provide for independent mediation or arbitration. In the alternative, a buy-out clause could be triggered allowing the purchase of the interest of one partner by another. Finally, the agreement might provide for either partner to exercise the power to dissolve the partnership, as provided in applicable law.

50/50 Stock Ownership with Nimble Having a Tiebreaking Vote at the Board Level

- An alternative to a Board with an even number of directors (half appointed by each joint venture partner), is to have an odd number of directors with an independent director appointed upon the agreement of both parties. In some cases, the independent director will only vote in the event of a deadlock.

Local selects management with Nimble having a veto right (exercise of which is reasonable) over the CEO of the JV

- Both quality of management and carefully defining management responsibility are critical. Management dominated by one party or whose hands are tied unless both parties agree is unlikely to succeed.
- Senior management should be chosen early by agreement among the parties and should have a clear charter and authority (including reporting lines).
- Having an agreed business plan which management will execute allows management to be more focused and productive and avoids disputes.

IJV as Exclusive Producer of Nimble-Branded Product in the Asia Pacific

- Territorial exclusivity may be appropriate when the local partner has a strong brand or strong distributions channels. Exclusivity may also be required by governmental regulation or license.
- If exclusivity is granted, it should initially be only in the jurisdiction in which the IJV is located. Those rights should be conditioned on performance. Exclusivity in the other Asia Pacific jurisdictions probably should not be granted until performance benchmarks have been met in the local jurisdiction and the IJV has the demonstrated capacity to perform well in other jurisdictions. Even then, performance benchmarks should be set.

You begin negotiations alongside Pushy to work out the details of the JV with Local. During the initial meetings, however, you learn that Pushy's team and Local are already designing products and putting together specifications with the goal of launching the product in Hypothetica (the first launch country) in 6 weeks.

Local has started to identify people from its company who could serve as management of the JV and those people are working on the new products.

What's your advice?

Explain the downsides of starting to work together before agreeing on the JV structure and how the JV will operate in the local environment

- Local regulatory/legal issues exist which will need to be addressed before the JV will be able to launch its products in the local market.
- Must get off on the right foot with government officials (including the tax authorities) from the start of the JV -- critically important relationship for the JV.
- Working together to design products without a written agreement about who owns the design and how the upside (e.g. income) and downsides (e.g. liability for injury caused by defective design) will be allocated may lead to disputes about ownership and allocation of profits and losses relating to the jointly-developed product and create potentially serious relationship issues for the JV.

JV Management Roles Issues

- By letting people who Local has identified as possible JV management candidates start to work on the JV activities, Pushy may have led them to believe that they will get those roles.

- Your management , however, will want to have its people in the CEO and CFO roles (at a minimum). You need to pay attention to what your management wants and keep them informed and “on side”.

- Working together without having agreed rules about which JV partner fills a management position is likely to lead to misunderstandings (especially given local partners’ sensitivity to being treated as inferior to their “arrogant American” partner) which could damage your relationship with Local.

THE BOTTOM LINE:

Lack of an agreement and a shared understanding from the start of the JV about the goals of the JV, how they will be achieved and the allocation of rewards and risks relating to the JV's activities leads to disputes which may create ill will between the JV partners and seriously undermine the JV (and its bottom line).

THE GOLDEN RULES:

- Get involved early with your JV business people and your management in the main office and stay involved.
- Early (and frequent) communication between the JV partners at all levels of the JV organisation about their goals and plans and alignment of the JV partners on how they will achieve those goals is critical to the JV's success.
- Understand local laws (and local government's sensitivity to corruption in the country) and remember to look out for potential FCPA issues.

Local wants to provide back-office services to the JV at a cost plus mark-up basis. Pushy is happy to do this because he wants to make sure the JV starts operations ASAP.

What's your advice?

Contracting for Services with Your Local JV Partner

- How will the JV decide what level of services it needs from Local?
- Should there be a mark-up on Local's cost?
- How do we know that Local's cost is its actual cost?
- What happens if we (and the JV) are not happy with the services provided?

Practical Tips

Possible protections:

- Service Level Agreement to define services and cost.
  - Local law advice on SLA is important to ensure availability of remedies/termination.
- Local's directors cannot participate in discussions surrounding performance of Local in providing services.
- Obtain estimates from third party providers for services or do audit of Local.

You next start speaking with Local's General Counsel about the governing law of the JV. You state Nimble's standard position, which is that Delaware law should apply. Local takes the position that Hypothetical law must apply. Pushy wants to agree to Hypothetical law.

<u>What's your advice</u>?

The choice of law provision in an international joint venture agreement depends on how you evaluate a few key considerations:

- Parties typically choose the law of the jurisdiction where the joint venture is located.
- Examine whether the law of a neutral jurisdiction is preferable for your company.
- Venue is another consideration. Should it be mutually convenient or inconvenient for both parties?
- The governing language of the contract can be a factor to consider. The prevailing language could influence choice of venue and jurisdiction.
- Will legal disputes and business disputes be resolved in the same way?

Practical Tips:

- When drafting your JV agreement, clearly state how disputes between the partners are to be resolved.
- Adopting a mechanism for escalating disputes through certain levels of management is usually prudent.
- Do you want unresolved disputes to be determined by mediation, arbitration, or litigation?
- When selecting governing law for the contract, and venue for dispute resolutions, consider whether you want unresolved disputes to be resolved by litigation, mediation or arbitration.
- One possible solution: binding arbitration, using the Rules of Arbitration of the International Chamber of Commerce, in a venue which is equally convenient (or inconvenient) to both parties.
- Your JV agreement should have detailed provisions for dissolution, including procedures to be followed in the event of dissolution.

Local wants the JV to register Nimble's trademarks in the Asia Pacific region in the JV's name to ensure that the JV doesn't face problems importing products through Customs. Local offers to put a provision in the JV agreement providing that, at the end of the joint venture, Nimble can buy back the trademarks at the JV's cost basis.

Is this acceptable?

Intellectual Property Registration Issues

- Allowing any third party to register your IP is dangerous:
  - provides leverage in event of future dispute
  - can result in litigation in foreign jurisdiction to reclaim IP
  - your only protection over third party registering in other trademark classes is the JV agreement.

Practical Tips for Avoiding Intellectual Property Registration Problems

- Instead:
  - A license to use Nimble’s IP should be sufficient to allow the JV to perform the business of the joint venture.
    - The license should prohibit Local and the JV from registering Nimble’s IP or to use it in any way without Nimble’s consent.
    - It should also prohibit both Local and the JV from using Nimble’s IP in a company name.
  - A statement or agreement can be filed with Customs addressing import/export issues.

You discuss with Pushy the need to ensure that Nimble has approval rights over the products distributed by the JV and over local distributors. When you discuss this with Local, Local states that this can be accomplished through Nimble's tiebreaking vote on the board.

Do you agree?

The advice you give depends, in part, on how joint venture governance is set up.

- A typical structure is a board of directors which make high –level decisions, and a team of officers and managers who conduct day-to-day operations
- What issues or actions require board-level decision making?
- What are the powers and authority of the managing executive of the joint venture?
- Who has responsibility for day-to-day operations?
- How are the managing executive and officers appointed? By one party? Both parties?
- In this instance, who has management responsibility for distribution?
- Authority of joint venture officers vs. authority of the board

Practical Tips

- When drafting your joint venture agreement, you will need to be clear about:
  - Board decisions vs. management decisions
  - Who approves the joint venture business plan
  - In this instance, who has decision-making authority about product distribution and path-to-market
  - Authority to set and change strategic direction
  - Authority to create and change organizational structure.

Finally, you start discussing how the JV will end. Pushy doesn't want to talk about this as it contemplates failure of the JV, which he knows will succeed. You have had previous discussions with the Board in which they indicated that they do not want Nimble's international expansion to result in potential liability to the company, management, or the Board if a joint venture needs to be dissolved because it was unsuccessful.

You explain this to Pushy, and he says that you are worrying too much because it is a separate company, so Nimble couldn't possibly be held liable.

<u>Is he right</u>?

Explaining the Facts of Life to Pushy …

- More than 66% of JVs fail in their first three years and more than half of those that survive ultimately fail – our company's senior management have made it clear that they expect us to address significant risks like this up-front.
- In a number of jurisdictions, a company may have liability for the unpaid taxes and pension contributions of its affiliates.

Where's the Exit?

- When negotiating the JV agreement before the JV starts, consider carefully the pros and cons of the various exit and termination scenarios and strategies in order to come up with robust termination provisions for the JV agreement which have "buy-in" from all JV partners (and in order to put some of them in place from the start of the JV).
- Even if the JV agreement gives each party a right to terminate, it may be difficult to terminate the JV in practice (e.g., if your JV is producing a product that is important to the local economy or because of local law restrictions).

Local Laws / Regulations May Affect Ability to Terminate JV or Partner's Interest in JV

- Local tax issues on a sale of JV interests.
- Local employment law issues (such as "TUPE" and similar laws in Europe).
- Local law limits on maximum and minimum shareholdings for foreign and domestic JV partners (particularly if the JV involves a regulated industry or is a project which the JV won in a public tender).
- Foreign investment review and other governmental approvals (including competition/anti-trust approval) may be required for transfers of a JV partner's interests to the remaining JV partners or to a third party.
- Local restrictions on certain exit options (e.g., local law may prescribe the valuation method to be used).

Winding Up the JV's Business and Disposing of the JV's Assets

- Exit and termination provisions must address what will happen to the intellectual property and other property of the JV under the various exit or termination scenarios in the JV agreement.

ENDING THE JV –
Try Not to Slam the Door When You Go…

Consider how the decision to terminate the JV may affect your company's future access to the local market and your company's relationships with:

- your soon to be ex-JV partner – Is the JV partner and/or its management influential in the local market?
- local customers and suppliers;
- local government officials;
- competitors;
- third parties which have contracts with the JV; and
- employees of the JV or its partners.