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**BUSINESS COUNSELOR'S GUIDE TO MANAGEMENT AND
OPERATIONAL GUIDELINES FOR JOINT VENTURES**

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Successful management and operation of a joint venture, or “JV,” is a difficult achievement that requires a substantial amount of planning, and often long and candid debate between the parties, and care must be taken during the process of drafting agreements, policies and procedures to ensure that parties address as many of the contingencies as they can early in the process. In order to facilitate all of this, the following questions should be thoroughly vetted by the parties regarding management and operation of the JV:

1. What governance structure model should be selected for the JV?

Devising an appropriate structure for the management and control of the JV is one of the most important matters to be negotiated between the parties. In general, there are three basic governance structures from which the parties can choose when deciding upon how to manage the business operations of a JV—operator, shared and autonomous—and the attorney should be prepared to discuss each of these alternatives with the client.

2. How should control of the board initially be allocated?

Obviously, one of the most important issues for the parties to resolve is the initial allocation of control of the board and the parties may choose from among several commonly used structural forms: one party controls the board with no restrictions on the rights of the controlling party; one party controls the board but certain actions cannot be taken without the consent of all of the directors; one party controls the board initially but provisions are made for a shift in control upon the occurrence of one of several events specified in advance by the parties; the parties share control of the board but provisions are included in advance for resolving deadlocks and/or shifting control to a single party upon the occurrence of one of several events specified by the parties; and provision for one or more mutually selected independent directors (i.e., directors not affiliated with either party

who have relevant experience in the activities being addressed by the JV) accompanied by voting procedures which vest final decision-making authority in the independent directors in those situations where the parties are unable to reach a consensus.

3. What procedures should be implemented for shifting control of the board?

At the same time that initial allocation of board control is being determined consideration should be given to providing a mechanism for shifting control to one party after the passage of a specified period of time or upon the occurrence of one of several events to be agreed upon by the parties. While such “vote-switch” procedures will allow one of the parties to elect a majority of the board of directors, they need not alter the respective interests of the parties in the profits of the JV. Depending upon the circumstances, a change in control of the board may be accompanied by corresponding changes in the scope of authority provided to the body in the charter documents of the JV. Apart from a change in the primary business activities of the JV, it is most common to see the parties provide for a shift in control when the JV fails to achieve certain performance objectives, thereby placing the success of the JV in jeopardy, or when the activities of the JV are subjected to the effects of one or more specified external events. For example, a party engaging in the JV in order to improve distribution of its existing products in the local market may seek control of the enterprise in the event that the level of sales does not meet certain specified minimum amounts. Once control has been achieved, the party may initiate appropriate changes in local personnel, modify the business and marketing plans of the enterprise, or even suggest that the local party cannot provide the anticipated amount of distribution support. Also, not surprisingly, a party may be required to surrender its ability to control the actions of the board when it defaults in its contractual obligations to the JV.

4. What matters should require approval of both parties?

The parties need to strike an appropriate balance between permitting the officers and managers of the JV to make appropriate decisions regarding the operation of the enterprise and reserving the right, as the owners of the JV, to review and approve certain matters. The matters subject to the “shared control” of the owners, thereby requiring approval of both JV partners, should be limited to those items that are material to the performance of the JV, since making numerous actions subject to a unanimous vote will diminish, or even eliminate, the ability of the JV to quickly respond to appropriate business opportunities and changes in competitive and other environmental conditions. There are seemingly endless possibilities for the listing of items which might require the unanimous consent of the parties (or a supermajority vote of the board). It should not be surprising to see that the parties must agree on large capital expenditures, sales of material assets, creation of liens or encumbrances on the assets of the JV, approval of the annual operating budget and strategic plan (and material deviations from the budget or plan), admission of new parties, amendments to charter documents and dissolution/liquidation of the JV.

5. What procedures should be implemented for resolving disputes?

Whether the JV is a “50-50” company or one party owns more than 50% of the JV but has agreed to supermajority voting provisions, the possibility of “deadlock” must be taken into account in structuring the enterprise. Although it may be somewhat awkward to spend inordinate amounts of time before the JV is even formed in debating the consequences of any failure of the parties to agree, some procedures for resolving a dispute between the parties without having to resort to the costs and aggravations of litigation are usually desirable. Among the more common methods are mediation and arbitration; bilateral discussions involving senior management from both parties; swing-vote directors, including delegation of the final decision to an independent director; and put-sell options (i.e., both parties may be given a right to “put” their shares to the other party at a fixed price, and the other party must either agree to purchase the shares at the price fixed by the party making the “put” or sell its own shares to the first party at the same price). Hopefully any deadlocks can be resolved; however, in some cases the parties must simply shut down the business, terminate the JV, dissolve the corporation and liquidate and distribute the assets.

6. How will the functional activities of the JV be conducted and managed?

While it may be hard to remember as the parties are slugging through the tedious process of drafting the documentation for a new JV the goal is to create a real living and breathing business that conducts all or most of the main functional activities such as research and development, manufacturing, sales, distribution, and service. During the planning phase the parties must determine which functional activities will be conducted by personnel employed directly by the JV and which activities, if any, will be conducted by one or both of the parties pursuant to ancillary contractual agreements between the party and the JV. For example, in those cases where the JV is to be engaged in significant research and development activities relative to the production and commercialization of specified products, one of the parties may be engaged to conduct a specified program of research and development. The JV may enter into a research and development agreement with the party providing for various payments to be made to the party, while allowing the JV to retain ownership of the results of the development program. Ancillary agreements may also be used for supply arrangements, technology licenses, leases of personal property and administrative services. In many cases, these ancillary agreements are factored into the computation of the overall consideration contributed by the party in exchange for its interest in the JV.

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Footnotes

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