Business Transactions Solutions § 284:70

Business Transactions Solutions
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§ 284:70. Article: Arbitration for Transactional Joint Ventures (not maintained)

Arbitration fits well into the needs of transnational joint venture investors for a variety of reasons: the cost of litigation in the U.S. tends to intimidate foreigners, huge court backlogs and undeveloped legal systems scare off Americans from using courts in many foreign countries and both parties tend to fear a "home court" advantage going to the other side. Arbitration also provides a very useful neutral ground for handling disputes between parties from different cultural backgrounds operating under different legal systems. Efficiency, both in time and costs, is also promoted by the use of less formal procedures using fewer restrictions on the discovery process and presentation of evidence. Privacy is also promoted, and this can be a key factor where neither party wishes to have their dispute, and/or the related facts, aired in public. In some countries, social and cultural norms are so heavily weighted against public disputes that litigation would be unacceptable to a foreign party.

While the parties can, and often do, rely heavily on the default procedures included in the selected arbitration rules, when the resources invested in the transnational joint venture are substantial and the issues are expected to be material to the overall business operations of the parties it is best to take the time to discuss, negotiate and implement a custom drafted arbitration clause that covers key topics including the scope of the arbitration clause, applicable arbitration rules, institutional versus a*d hoc* arbitration, selection of arbitrators, special arbitrator skills and qualifications, the language of arbitration, discovery, judicial intervention and confidentiality.

Scope of the Arbitration Clause

Parties may well not want all disputes to require formal arbitration, and as a practical matter, a functional joint venture relationship will require a degree of cooperation such that minor issues will and should be handled informally. Of course, before resorting to arbitration, which is by nature an adversarial proceeding with a clear winner and loser and can damage the parties' relationships, one should at least look into mediation. For many disputes, simply sitting down with a neutral mediator can help to clear the air and get the parties' concerns all out on the table. If the parties want to include a mediation provision in the joint venture agreement (or in a separate, attached agreement), they will need to determine the requirements for notifying all parties of the mediation process; how the parties should respond to such notice; how the mediator(s) will be appointed; allocation of costs and expenses for the proceedings; and an estimated time frame for the mediation process.

Careful drafting elsewhere in the joint venture documents can provide valuable guidance for the implementation of the arbitration clause. Generally, it can be dangerous to limit the scope of the arbitration; this can lead to enforcement problems because the losing party may claim the arbitrator overstepped his or her authority. Furthermore, a decision to go with arbitration should be entered into wholeheartedly—specifying the courts as a fallback method for resolving disputes could undermine the arbitration agreement.

The language used in the contract will determine what types of disputes are covered and how appeals are handled. “Arising out of” will only cover contract-related disputes. “Connected with” or “related in any way to,” however, will cover most if not all claims, including torts and fraudulent inducement. “Exclusively and finally” in England prevents all court review; in the U.S., however, courts would remain capable of reviewing the decision on the grounds provided by the New York Convention or the Federal Arbitration Act as those defenses are limited and fundamental.

Applicable Arbitration Rules

Parties should select rules of arbitration, and this can depend upon what country each joint venture party is from. For example, it is easier to get Russian and Chinese parties to agree to arbitration under the rules of the Arbitration Institute of the Stockholm Chamber of Commerce (“SCC”) than to those of the American Arbitration Association (“AAA”). Other commonly used rules for ration include those of the International Chamber of Commerce (“ICC”), the U.N. Commission on International Trade Law (“UNCITRAL”), or the London Court of Arbitration (“LCIA”).

Institutional or *Ad Hoc* Arbitration

Institutional arbitration is that which is administered through a preexisting organization established specifically for that purpose, and the ICC, headquartered in Paris, is a good example. Other institutions include the AAA in New York, the LCIA, and the SCC. *Ad hoc* arbitration is arbitration in which the parties agree to follow a chosen set of procedures that are not carried out under the administration of an arbitration organization. This decision will affect the selection of rules because institutions will generally want to apply their own rules. However, rules suitable for *ad hoc* arbitration, such as the UNCITRAL rules, have also been used by arbitral institutions. Note that although *ad hoc* arbitration may be cheaper to administer, parties unfamiliar with this form of arbitration may welcome the structure and guidance offered by an arbitral institution. The preferred route is to draft the clause in favor of institutional arbitration. At the time of the dispute, if the parties agree, it is possible and relatively easy to move from an institutional to an *ad hoc* proceeding, while the reverse is more difficult. If *ad hoc* arbitration is chosen, the selection of arbitrators is crucial to its success and the selection of an appointing authority should be addressed with great care in the arbitration clause.

Selection of Arbitrators

The parties can have any number of arbitrators, although a single arbitrator or a panel of three arbitrators is standard. The choice between a single arbitrator or s panel often depends on the amount of money at stake. A “breaking point” can be established to determine the number of arbitrators in relation to the amount in controversy (i.e., if the amount is less than $1 million, there will be only one arbitrator, but if it is more, there will be three). This is designed to ensure that the amount of money spent is proportional to the amount at stake. The contract should also specify whether the parties will select the arbitrators and how, or if they will be selected by an institution, *i.e.,* the AAA. A common way to fill a panel of arbitrators is to have each party select one arbitrator and those two then select a third, “neutral” arbitrator. If there are more than two parties to the arbitration proceeding. it may not be possible for each party to select its own arbitrator for a panel. Courts previously refused to force multiple parties to pick a joint arbitrator. However, the rules of the AAA and ICC provide that multiple parties must agree upon an arbitrator and, if unable to do so, the organization will appoint someone.

Special Arbitrator Skills and Qualifications

If there are special skills that the arbitrator will need in order to handle the issues that may arise in a particular joint venture, such a requirement should be in the arbitration clause. The general rules of the ICC and AAA require impartiality and independence. The parties may want to obtain a statement from the arbitrators specifically agreeing to act impartially and independently. They

may also want to adopt the International Bar Association's rules of arbitrator ethics, which are not binding unless specifically adopted.

Language of the Arbitration

Absent a designated language of arbitration, several rules of arbitration provide for the arbitrators to select the language. Generally, the language will be that of the country in which the arbitration is held. This can result in significant translation costs as well as fundamental communication problems.

Discovery

Most arbitration rules allow for little or no discovery. The International Bar Association rules provide only for the exchange of documents to be relied upon by the parties at the arbitral hearing; and documents that can be identified with specificity that have been exchanged with third parties. The parties may broaden the scope of discovery, but must do so explicitly. Most foreign countries do not permit discovery of documents by category, as is allowed in the U.S. Therefore, the parties must state that discovery will be allowed by category if that right is desired. Also, most countries do not require that the arbitrators respect the rules of privilege and this must also be spelled out in the contract.

Judicial Intervention

Often, one party to the arbitration will want an injunction or some other type of interim measure to prevent a continuing violation during the dispute resolution process. The contract should specify whether interim measures will be allowed since most courts are split on the issue. The contract should state whether seeking interim measures will waive the right to compel arbitration. The parties should also consider whether an appeal of the arbitrators' decision will be permitted. Appeals will generally be governed by the law of the country where the hearing took place. The parties can, however, broaden or narrow that review. A standard clause to broaden review recites that the court will review “errors of law or fact by the arbitrators.” U.S. courts are reluctant to allow the parties to preclude any review; most will look for fundamental due process violations even if the contract provides for no review.

Confidentiality

Confidentiality is imposed upon arbitrators by the rules of the various organizations. None of the rules, however, impose obligations upon the parties. The contract should, therefore, address this issue as it relates to the fact that arbitration is occurring; the details of the award; historical documents; and documents prepared for the arbitration.

Other Matters

In addition to the issues discussed above, the arbitration clause should address other matters such as the place of the proceeding —the arbitration should be conducted in a country that is a party to the New York Convention on enforceability of awards; the law to be applied to the substance of the dispute; pre-arbitration procedures; and the power of the arbitrator to grant interim protection measures (e.g., injunctive relief) in the contract. When drafting an arbitration clause, it is important to consider whether the issue can be arbitrated under local law (in some jurisdictions, certain issues must be resolved in court) and whether the prevailing party will be able to enforce the award. Although the parties will be able to select the substantive laws governing the arbitration and may even be able to establish some of the rules governing the arbitration hearing, local law will continue to govern the arbitration in general (i.e., whether the local court will issue interlocutory relief or review the award). Additionally, there is the question of whether or not the local law allows for arbitration of disputes; however, this typically is not a problem

and foreign courts will also usually uphold a choice-of-law clause so long as there is a reasonable relation between the law or forum chosen and the activities of the joint venture.

Footnotes

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§ 284:71. Article: All Good Things Must End: Planning for Unwinding a Joint Venture (not maintained)

The following article discusses the issues that attorneys should cover with their clients regarding planning for unwinding a joint venture even before the relationship is up and running. While it may be difficult for the client to think about termination issues when the deal has yet to be finalized, the reality is that the end date will inevitably come and there are steps that can be taken in advance to ease the process and avoid unnecessary stress and disputes.

Commentators have often suggested that more than 50% of international joint ventures ("JVs") survive no longer than five years. In some cases the short term nature of the relationship may be originally contemplated by the parties and built into the documentation; however, it is more likely that the breakup of the JV will be "unplanned," at least in the sense that it occurs before the end of the JV term originally specified in the formation documents. The attorneys working with the parties to a prospective JV should consider the almost inevitable termination of the JV at the very beginning of business relationship and make sure that the following questions are asked and that the answers are used to draft appropriate provisions in the JV documentation before a crisis erupts:

1. *What is the likelihood that one or both of the parties will begin to have business objectives that conflict with the ongoing operation of the JV?* Issues to consider include the possibility that one party may become interested in developing business relationships outside of the JV or that a party may develop, and wish to independently exploit, products which may compete with, complement or replace the products made by the JV. Another common situation is that one of the parties wishes to have 100% control over its activities in the geographic area or business sector in which the JV is operating.

2. *What is the likelihood of material changes in financial or business health of one of the parties or the legal and regulatory framework in the geographic area or business sector in which the JV will be operating?* For example, unforeseen financial difficulties of one of the parties may inhibit its ability to make the expected contributions to the JV and thus adversely impact the projected growth and stability of the JV.

3. *What is a realistic business horizon for successful completion of each of the particular activities that the parties have incorporated into the initial business plan for the JV?* The JV documents must include provisions that specific the duration of the JV, even if the parties decide that the JV is to have perpetual existence and then build in procedures for early termination. While the parties may truly anticipate that the JV will be successful and continue for a number of years with expansion into new functional, technical, product, and market opportunities, an effort should be made to set a realistic target date that the parties can refer to as a milestone point for determining if the JV is still viable. The term of the JV should allow the parties to realize a satisfactory return on their invested capital by permitting completion maturation of the distribution function, full functional depreciation of the venture's assets, and, hopefully, the attainment of the economies of scale often associated with high volume production activities.

4. *What are the key functional and financial objectives of the JV and how long is it expected to take for the JV to launch and complete each of the activities necessary to realistic pursue those objectives?* This analysis is essential in identifying an appropriate initial term for the JV and should be done as part of the larger process of preparing a business plan for the JV.

5. *Is there a realistic possibility that the activities of the JV will be expanded into neighboring markets or product areas?* If so, expansion may be built into the JV documentation at the outset; however, expansion should be conditioned upon unanimous agreement of the parties.

6. *What restrictions should be placed on transfers of ownership and what procedures should be included in the JV documentation to address the desire of one of the parties to transfer its interest in the JV?* As a general rule, the parties will typically agree to a strict prohibition on any sale or transfer of the shares for a specified period of time, usually corresponding to the initial term of the venture. After the restriction period has ended, the parties will usually agree to a "right of first offer" or a "right of first refusal."

7. *What events might trigger a pre-termination withdrawal of a JV partner?* The parties should consider what events might arise that would justifiably lead to an early withdrawal of a JV partner. Examples include, a fundamental change with respect to one of the parties, such as a change in ownership of the party, or the occurrence of an act or event relating to the JV itself (e.g., a material breach of the JV agreement).

8. *What procedures should be included in the JV documentation to facilitate the early withdrawal of a party?* There are several different procedures that might be used including granting the right to either party, at its option, to liquidate and dissolve the JV and then including a valuation mechanism and an option in favor of the other party to purchase the interest of the party that wishes to withdraw, thereby allowing the business activities of the venture to continue; permitting either party to sell its shares to a third party, perhaps in a public offering, subject once again to a right of first refusal in favor of the other party; using a buy-sell option which permits one of the parties to set a price on its shares and then allows the other party to choose between buying the shares or selling its own shares at the stated price; giving one of the parties the right to sell its interest in the JV to the other party after a fixed period of time at a price to be fixed by an independent appraisal; and giving one of the parties the unilateral right to purchase the shares of the other party after a fixed period of time, with the price to be determined at the time the option is exercised.

9. *What process should be used to value the interest of a withdrawing JV party?* Valuation sets the price for the interest of the withdrawing party and it is best to put procedures for valuation in place before they are needed. Different valuation methods may be used depending on the stage of the development of the JV and the most common choices with respect to valuation formulas include the book value of the interest; the cost of the interest to the party plus an annual increment; capitalization of earnings; or some combination of two or more formula measures. In appropriate cases, minority and marketability discounts and control premiums are used to adjust valuations that are based on other factors.

10. *What procedures should be included with respect to formal liquidation and dissolution of the JV?* Termination of the JV without continue of the JV business by one of the parties is carried out through liquidation and dissolution of the business entity, a process which is largely dictated by applicable law and any agreements between the parties regarding the distribution of specified assets of the JV. Orderly and fair liquidation of JV assets should be considered before liquidation occurs and specific issues that should be covered in the JV documents include preserving the original assets of the parties (and returning them to the contributor, if possible), valuation and distribution of non-cash assets and intangibles developed during the course of the JV within the JV itself, satisfaction of claims of creditors and compliance with local laws and regulations protecting the rights of employees who will be losing their jobs when the JV ceases operations.

11. *What will be the rights and obligations of each of the parties following termination of the JV?* Even though the formal JV relationship is terminated and the entity is liquidated and dissolved, certain agreements between the parties will survive the completion of the formal business relationship. For example, the parties will remain obligated under the terms of any

agreement with respect to the confidentiality of proprietary information that was exchanged or otherwise received in the course of the JV. In addition, the parties should set aside a reserve, or purchase insurance, to cover the claims of creditors and other third parties that may arise following the dissolution of the JV.

Footnotes

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