BUDDLE FINDLAY

Long term joint ventures – surviving the honeymoon

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Sometimes two heads are better than one, especially when it comes to business. The advantages that a successful joint venture can bring to collaborating parties are significant.

Together, the parties to a joint venture can share the burden of risk and cost, benefit from the value of different experiences and expertise, and leverage complementary customer and/or supplier bases. There is a lot to be excited about at the beginning of a joint venture. But what happens when the honeymoon is over, and wedded bliss is replaced by something a little less sweet?

Provided there is strategic and commercial alignment between the parties, joint ventures are capable of delivering long term results. However given the potential for a breakdown of any joint venture relationship, there is value in putting in time and effort up front to develop legal documents that are both capable of lasting the test of time, and that provide solutions if the relationship ever turns sour. Potential issues with joint ventures can be particularly acute when parties are intending to create a venture with a term of greater than ten years.

Commercial stage gate, legal stage gate

Before anyone tables a lengthy draft agreement, parties should work through the commercial fundamentals of the venture, checking their requirements are in alignment. Fundamentals generally include the proposed commercial model for the venture, tenure expectations, and approach to establishment costs, commercial objectives, committed funding levels, balance of equity and debt, and the prospect of others joining the venture in future.

If the commercials are 'ticked off', one approach from there is to work through what are viewed as 'legal stage gate' issues. This is all about picking out what may end up being the tough legal points, and tackling them head on in advance of documentation and less controversial points. In our experience this can save time and cost, and there is little point in drafting a detailed agreement if the parties have vastly different views on key legal issues.

So what to focus on first?

Governance and decision making

This includes board appointment rights, and establishing a clear list of reserved matters that need either a majority or unanimous decision at board level, or that need to be referred to the investors for approval.

In terms of reserved matters, there is a view that a joint venture is more likely to be successful if the entity's board is able to get on and govern, rather than being very closely supervised by the investors. Board reserved matters generally protect parties in any event.

Deadlocks and Disputes

No agreement will cater for every eventuality, and there are many options for dealing with deadlocks and disputes. A rational starting point is often a staged process requiring operational representatives of the parties to discuss the matter. If they are unable to agree, the matter can be referred to the CEOs of the investors. If the CEOs cannot agree, the matter could then be referred to the full boards of the investor entities. There's nothing more likely to motivate individuals to be pragmatic and considered than the idea of admitting defeat and passing a matter to the chairman and/or full board.

Doing nothing is also always an option - maintaining the status quo where the parties cannot agree can be logical in a joint venture scenario.

Alternatives include giving a casting vote to an independent director, or referring a matter in dispute to mediation process or, if appropriate, expert determination.

There is no 'one size fits all' and parties may well agree during the legal stage gate discussion that different resolution processes will be followed for different types of disputes.

In most cases, the dispute resolution process should not have fast triggers to exit options. If the relationship is intended to be long

term, it should not be too easy to unwind. It's also wise to avoid making it easy for either party to manufacture a deadlock, particularly if this could be used to one party's advantage.

Exit arrangements

While there is enthusiasm from both sides, parties should tackle potential 'doomsday' scenarios. Again, it's easier to discuss this topic in advance of being 20 or 30 pages into a legal agreement. It is in everyone's interests to think about how the relationship would be unwound if that ever became necessary.

Considering the key 'triggers' for divorce, time frames, 'who gets what' and 'who would pay what' can be a bit fraught, but if handled properly the discussion can build confidence in the venture and be reaffirming.

It will often be appropriate to have consequences of termination that differ depending on the reason for termination – for example, an exit triggered by repeated deadlock could have different consequences to an exit as a result of a material unremedied breach event.

The parties should also address how they will each manage communications regarding termination (given the potential PR risks for both the joint venture and each of the investor entities).

Competition

The parties should also turn their minds to whether there should be any restraints on the joint venture partners competing, either with the joint venture or with each other. Any non-competition restraints need to be lawful, and the parties will need to take into account the new prohibitions on cartel provisions under the Commerce Act. This is an area where the parties need to consider both their own interests and the interests of the joint venture itself.

Future-proofing the venture

Parties to any long-term venture should expect changes over the course of their relationship and should build some flexibility into their documents. The longer the proposed term, the more difficult it is to predict how the joint venture's business (and its market) will develop and change over time. Attempts to work through every possible issue that might lie ahead tend to result in a lengthy (and costly) negotiation process, and often do not add value – the issues which do ultimately arise will likely be the ones that no-one predicted.

These comments apply equally in terms of future proofing the documents for potential incoming investment parties. While this possibility should not be ignored, it's likely that if new investors join the venture in future then there will need to be some renegotiation of the joint venture documentation.

Building in a review process for the parties can be useful, so that at appropriate intervals there is a process for the parties to check the ongoing suitability of aspects of the documents. This more flexible approach is supported by our own experience and by broader historic research regarding joint ventures. Joint ventures which evolve are considered likely to be more successful.

Launching the joint venture

Given the time and effort that goes into negotiating useful joint venture agreements, there is real value in making sure that the negotiation process includes at least some of the people who are intended to be part of the joint venture's governance going forward. If the reins are handed from a negotiating team to an implementation team without any cross-over between those individuals, the parties risk a loss of understanding of the background and agreed objectives. The composition of the initial board and the senior management team is therefore very important, and should not be a process that is rushed at the last minute to 'fill seats'.

In terms of the joint venture's senior management team, it can be helpful to have people who are driven to make the joint venture a success. To that end, the parties should think about how the joint venture's senior management will be motivated. It's also helpful to have at least one senior manager who has had prior experience in managing a joint venture, as they will likely appreciate some of the intricacies of working with the investor entities (and may have strategies for managing communications with the investors).

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