

MANAGEMENT, CONTROL AND DIRECTION OF JOINT VENTURES

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Introduction

Troubles with the management, control and direction of joint ventures can lead straight to joint venture failure.

When negotiating, and subsequently drafting, the joint venture agreement and all other documents which define and circumscribe the relationship between the joint venture itself and each of its participants (referred to here as “ancillary agreements”), attention must be paid to both the broad principles, and the practical realities, of management, control and direction. Such attention may increase the chances of joint venture success.

A marriage of convenience?: Relationship is paramount

The marriage analogy is often used in relation to joint ventures. It is a highly appropriate analogy because fundamental to the success of a joint venture is an appreciation by its participants of the fact that a joint venture relationship is just that – a relationship.

Pre-nuptial agreements

The joint venture agreement and any ancillary agreements comprise something akin to a pre-nuptial agreement. And as unromantic as it may seem, careful attention should be paid to articulating the nature of the relationship, how decisions are made, what the intended roles of the participants in the joint venture are, and what is to happen if there is a break down of the relationship.

Accounting for these matters at the outset of the relationship is important as joint ventures, by their nature, bring together participants from different backgrounds with differing specialities, expectations and objectives. They are a marriage of convenience. Even in domestic (as opposed to international) joint ventures, cultural differences between the participants can be substantial and must be anticipated, accounted for and managed.

Relationship is paramount

But as with a pre-nuptial agreement, so too with joint venture agreements and ancillary agreements do limitations apply. As with any contract, the relationship between the participants will inevitably out grow and transcend the original contractual terms. Even tightly worded joint venture agreements and ancillary agreements will not save a joint venture if there are irreconcilable differences between the participants.

Nevertheless, attention given to these agreements will at least ensure that, from the outset, the participants understand the purpose of the joint venture, its business, and the elements most critical to its success. From a practical perspective, however, the participants need to understand that the joint venture agreement and any ancillary agreements cannot substitute for a true understanding between them as to the purpose of their relationship and the commitment of each participant to that relationship.

Marriage or just dating?: The nature of the relationship

I have referred to marriage as a useful analogy in relation to joint ventures. But what exactly is the nature of the relationship to which the participants are committing? And what must be the level of their commitment to each other? The participants in a joint venture will do well to agree and record the nature of their relationship (and so their level of obligation to one another) at an early stage, as this will in turn impact on issues of management, control and direction.

Structure

The form of the joint venture relationship may often be a partnership. But a joint venture may be an undertaking or activity pursued in a form other than a partnership: such as a company, a trust, an agency, or joint ownership. In the absence of careful articulation in the joint venture agreement and any ancillary agreements, the nature of the relationship intended by the participants can, during the lifetime of that relationship, be difficult to discern. The boundaries between a partnership (which is fiduciary in nature with obligations of confidence and trust between the partners), a joint venture (where the participants may have a degree of responsibility to each other) and a simple contractual relationship (where the parties may be more explicitly motivated by selfish gain) may be blurry.

Partnership?

The term "joint venture" does not have a settled meaning at law. As a matter of ordinary language, the term "joint venture" refers to an association of persons for the purposes of a particular trading, commercial, or other financial, undertaking or endeavour with a view to mutual profit, with each participant usually (but not necessarily) contributing money, property or skill.

Under the Partnership Act 1908, a partnership is the relation which subsists between persons carrying on a business in common with a view to profit. But this is in part the nature of a joint venture. The Partnership Act 1908 also states that there may be a partnership for a single venture or undertaking and, subject to any agreement between the partners, a partnership, if entered into for a single venture or undertaking, is dissolved by the termination of that venture or undertaking. So too a joint venture may be project specific or more enduring.

It has been suggested that an important distinction between a partnership and a joint venture is, for practical purposes, the distinction between an association of persons who engage in a common undertaking for profit and an association of those who do so in order to generate a product to be shared amongst the participants. The feature which is most likely to distinguish a joint venture from a partnership in that case is the sharing of products rather than profit. But even that distinction does not account for the multitude of variations between joint venture relationships.

Joint venturers who are not partners are not subject to the provisions of the Partnership Act 1908. As such, the provisions of the Partnership Act 1908 governing the relations and liability of partners to persons dealing with them do not apply; the provisions governing the relations between partners and their liability for each other's wrongs do not apply; and the provisions governing the dissolution of a partnership and its consequences do not apply; rather, the terms of the joint venture agreement will be relevant in determining the ultimate destination of joint venture property and the payment of the joint venture's debts. The power of one participant in a joint venture to bind the other joint venture participants does

not depend on the Partnership Act 1908 but on the terms of the relevant joint venture agreement and ancillary documents and the ordinary law of agency.

Fiduciary obligations

And so it is important that joint venture participants make it clear in the joint venture agreement and any ancillary agreements what the nature of their relationship is to be. Without close attention to the terms of the relationship, the relationship may be found to be closer than the parties initially desired or intended, and this may have implications for management, control and direction.

A key characteristic of the partnership relationship is its fiduciary nature. A relationship is characterised as being fiduciary in nature if there is the necessary level of confidence and trust between the parties. In a partnership, the partners are agents for each other and this may constitute a separate reason for the fiduciary character of a partnership. There may be no such agency between participants in a joint venture, but even in a partnership it is really the mutual confidence between partners which imposes fiduciary duties upon them and the same confidence may, in appropriate circumstances, be found to exist between participants in a joint venture.

Although the participants in a joint venture may not be partners in a partnership, it is still possible that the relationship between them may be found to be fiduciary in nature. Whether a fiduciary relationship exists will depend on the form which the joint venture takes and the content of the obligations which its participants have undertaken. Even if a fiduciary relationship is not found to exist between the participants in a joint venture, at the least duties to act reasonably and in good faith may, in the circumstances, be implied terms of the joint venture agreement and any ancillary agreements.

And so it is important that the joint venture agreement and any ancillary agreements make clear what the participants' intentions are and that their subsequent behaviour in the relationship is consistent with those intentions. A "no partnership" clause in a joint venture agreement or an ancillary agreement is a helpful starting point, but the subsequent dealings between the participants are what will give strength to their intentions.

Joint venture participants will do well to resolve and record the terms of the arrangement between them as soon as possible. A fiduciary relationship can arise and fiduciary duties can exist between persons who have not reached, and may never reach, agreement upon the terms which are to govern the arrangement between them. In particular, a fiduciary relationship may, and usually will, exist between prospective partners who have embarked upon the conduct of the partnership business or venture before the precise terms of any partnership agreement have been settled. In those circumstances, the mutual confidence and trust which underlie consensual fiduciary relationships are likely to be more apparent than in the case where the precise nature of the relationship between the participants has been expressly defined in the joint venture agreement and any ancillary agreements.

Who wears the pants?: Management

A unique feature of a joint venture is that it must be managed with specific attention paid to the sometimes divergent interests and divergent contributions of its participants. Interests and contributions are not always aligned.

While a joint venture may not be structured as a partnership (and often the joint venture agreement will expressly stipulate that it is not), the structure and form of a joint venture can still closely resemble a partnership model. In the absence of a clear management structure or an appropriate decision making structure, tie votes and impasses can develop. There must be a manager of the joint venture and the joint venture must have a decision making structure. The participants must be clear from the start about who wears the pants.

Structure

The structure of a joint venture may be:

- Integrated (i.e. it represents a partnership (at least in substance if not in form) in that the participants share profits and losses in proportion to their interests in the joint venture);
- Non-integrated (i.e. it is not a partnership in form or substance and there is no sharing of profits and losses; each participant takes on a specified scope of work and is responsible for the profits or losses associated with that scope of work); or
- A combination of the integrated structure and the non-integrated structure (i.e. each participant takes on a specified scope of work and is responsible for the profits or losses associated with that scope of work, but the participants also agree to act essentially as partners with respect to a portion of the necessary work. This more closely reflects the likely spread of specialist, as well as general, work required on larger, more complex projects).

Management

Control is often the driving force for a participant to enter into a joint venture rather than, say, a licensing or a manufacturing arrangement. Management of a joint venture usually reflects the amount of control that one participant will have. While there may be any number of management structures for joint ventures, they all in essence reflect two basic styles: controlling participant management or collective management.

Controlling participant

Where management is led by a controlling participant, the joint venture operates as if it were a subsidiary of that participant. Management decisions are made by the controlling participant's executives, located either in the joint venture or in the controlling participant's company. Although a board of directors may contain representatives of each of the participants, it serves more as a formality as the various management executives of the joint venture are selected by the controlling participant or in fact work for the controlling participant.

To protect itself from abuse, a non-controlling participant may seek to utilise certain safeguards, which most often take two forms:

- A share of directors pro rated to the shares held by each participant section 131

of the Companies Act 1993 permits a director of a company that is carrying out a joint venture between the shareholders to act in a manner which he or she believes is in the best interests of a shareholder even though it may not be in the best interests of the company. This is explicit statutory recognition of the existence of divergent interests between joint venture participants. But this is not sufficient to protect the interests of a non-controlling participant who risks being out-voted on key commercial issues; and

- A veto power on key decisions. Veto powers include those typically found in shareholder agreements relating to such matters as the disposition of major assets, merger or consolidation with other businesses, funding, liquidation, increase in capitalisation etc.

A particularly savvy non-controlling participant will preserve for itself an equal voice in a management committee created to be responsible for determining long term strategy, changes in which are also added to the veto powers. As with any passive investor role, reporting requirements permit the non-controlling participant to monitor the progress of the joint venture and foresee cash flow difficulties in advance of crises.

The controlling participant management method is almost always preferred by one participant with control over assets and strategy being a key issue in any joint venture. As a practical matter, however, it is useful only where one participant has the advantage of negotiating strength, good faith and, most importantly, substantially unequal capital contribution.

Collective Management

In an attempt to avoid explicit domination of one participant over any other, joint ventures often opt for a collective or joint management style. But this is problematic as well. Some would say it is fundamentally an unsatisfactory method of doing business, except where extraordinary participants are involved. However, this may be the solution most palatable to the participants.

The problem is that deadlock is the substance of the relationship – board of directors' representation is equal as are voting rights at participant meetings on all important matters. With collective management, the danger is the occurrence of unresolvable deadlock – a crisis which, if not settled, brings the venture to a halt. Fortunately there are a number of techniques which exist to deal with deadlock e.g. re-submittal, escalation, mediation, casting vote, arbitration, independent expert, put options, Russian roulette. But the greater the similarities between the parties (size, experience etc) the less likely they will consider deadlock resolution mechanisms necessary. Such mechanisms encourage creation and persistence of deadlocks when the truly commercial approach may be just to consult and agree on the way forward. Counselling and reconciliation may be possible with divorce avoided.

Gender roles: Who does what?

Obviously from a commercial point of view, a joint venture is attractive to its prospective participants on the basis that together the participants can take advantage of opportunities that may be unattainable for them individually. In this respect, the whole is greater than the sum of its parts.

Each participant in a joint venture will have different motivations and objectives in participating in the joint venture. And each will likely bring different values to the relationship. One participant may bring the necessary technical know how. Another participant may bring the required financial clout. Another participant may bring specialist knowledge of the local market environment. Another participant may supply particular goods or services to the joint venture itself.

As with any relationship, there will be a greater chance of success if the participants are clear from the outset what each of them brings to the relationship.

The best joint venture agreements and ancillary documents will clearly account for the joint venture's goals, define the role of each participant and set out the decision making process in each context. They will also outline an exit strategy in case the arrangement sours for one or more of the participants.

The joint venture agreement will clearly take account of the relationship between the participants as joint venturers. The ancillary agreements will articulate and govern the relationship between the joint venture itself and each of its participants in terms of what each participant might separately and additionally provide to the joint venture.

In this respect, attention must be paid to each of the participants' respective roles with a view to clear negotiation and delineation. There is no check list to follow, however. Not all joint ventures are created equal. In general the terms of different sale and purchase agreements will be reasonably similar; however, in the context of joint ventures, the terms of various joint venture arrangements may be radically different, one from another.

Identification of responsibilities

To capture the essence of the joint venture relationship, the responsibilities of the individual participants must be clearly identified.

At a broad level, the responsibilities of the participants can be separated into three main categories:

- those responsibilities which are specific to one participant such that they cannot be performed by another;
- those roles and obligations which are specific to any participant, but which are best performed by only one participant;
- those roles and obligations which are specific to each participant, such as the obligation to contribute cash, but which must be performed within a specific period of time.

Business Plan

Successful management, control and direction of a joint venture will depend in large part on the ability of the joint venture participants to identify where each or any of the participants in the joint venture are providing key goods or services to the joint venture.

In this respect, a business plan (that is, a commercial plan for the joint venture rather than simply the financial projections that may be drawn up for funding purposes) will assist the participants to agree the joint venture agreement and identify the elements of their relationship which must be governed by ancillary agreements. Just as with a marriage, the participants in a proposed joint venture should be clear from the outset about the core elements of their relationship and commit to communicating about any problems that arise in that area.

The elements most critical to a joint venture's success will depend on the particular joint venture, all prospective joint venturers will need to consider:

- management (as previously discussed)
- people
- supply
- product
- sales and distribution
- intellectual property and information technology
- support services, such as accounting and finance
- business processes
- funding.

In addition to the need for specialist taxation advice and the considerations that may arise where the joint venture is international, there is added pressure when one or more participants wears several hats by acting as a supplier, customer, or funding provider to the joint venture. In addition to negotiating the terms of supply as if the participant were not also part of the joint venture, the joint venture participants should consider the extent to which the provision of separate matters to the joint venture require separate recognition and reward. By way of further example, management of the joint venture may be effected from outside or from within. If management is effected from outside, a separate incorporated legal entity may be created but it need not employ any staff or enter into any of its own business agreements. In this situation, one or more of the joint venture participants may supply both management and some or all other services to the joint venture.

In this regard, there are, broadly speaking, two material issues to consider where one or more participants of a joint venture will provide goods or services to the joint venture.

Performance and reward

The first issue relates to the terms on which the relationship of the participant to the joint venture will operate throughout the life of the joint venture. Consideration should be given to:

- key performance indicators (ideally with an objective form of measurement)
- reporting results
- review of results
- identifying when service delivery does not meet key performance indicators

- methods for addressing poor service delivery
- reporting to the board and/or joint venture participants about both good and bad performance.

In particular, the participants need to consider whether supply will be on an arms length basis or whether supply will be at cost as one of the contributions of the joint venture participant to the joint venture.

Breakdown of the relationship

A second key issue that should be considered when one or more joint venture participant is to provide goods or services to the joint venture itself is, if a material issue arises within the relationship, whether or not it will constitute an exist trigger for the joint venture.

Ancillary agreements in the joint venture context are documents where “relationship clauses” are critical. It may be appropriate for a termination clause to be included in, for example, a supply contract such that it can ultimately be terminated if the supplier has failed to supply goods that meet critical performance specifications. However, it may be just as important (and probably more important for the participant who is the supplier) that the supply agreement contain mechanisms that will enable the joint venture participants to discuss any issue when it arises to ensure that there is not a premature termination. The impact of the termination of the particular supply agreement on the overall joint venture arrangement will also need to be considered. If an ancillary agreement is terminated, should that also lead to the possible termination of the joint venture itself.

This is where the communication between the joint venture participants and a structure for that communication may be what makes the difference between resolving an issue that arises and the failure of the joint venture as a whole. The structure should be carefully documented with at least a commitment to a period of discussion before any rights of termination are triggered under any ancillary agreement that could impact negatively on the joint venture. In any event, transparency in all aspects of dealings between the joint venture and any particular participant is required.

Although ultimately there may be a need for formal mechanisms of dispute resolution (such as mediation, arbitration or litigation), less formal mechanisms may better assist the participants to resolve their differences. As such, a scheme should be developed whereby formal remedies are seldom resorted to. For when the relationship breaks down, marriage counselling should always precede filing for divorce.