

Joint Ventures 2020

Contributing editors
Gavin Williams and James Farrell
Herbert Smith Freehills





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Lexology Getting The Deal Through is delighted to publish the third edition of *Joint Ventures*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on China, the Netherlands, Saudi Arabia and Thailand.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Gavin Williams and James Farrell of Herbert Smith Freehills, for their continued assistance with this volume.



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Introduction

Gavin Williams and James Farrell

Herbert Smith Freehills

In increasingly complex and connected global markets, joint ventures offer access to business and investment opportunities that may be less available to parties acting alone. New market entry, growing customer bases, sharing of capital expenditure or other costs, originating funding or investment, accessing expertise and technology, and achieving economies of scale are all examples of strategic objectives with the potential to be facilitated by joint ventures.

However, joint ventures are not without their challenges. Establishing a joint venture, legislating for funding, management and governance, and dealing with divergent ambitions and priorities over time can lead to inertia, ill feeling and the breakdown of understanding. Even the negotiation of joint ventures can be more long-winded and complex than agreeing a straightforward acquisition. It is therefore critical to afford ample time and attention to the initial stages in the design of a joint venture, its formation and throughout its life.

Not a term of art

The term 'joint venture' is not a term of art but one used generally to refer to the pursuit of a common commercial goal by two or more parties (or joint venture partners). Joint ventures can be organised by means of contractual arrangements or through separate corporate entities or other vehicles provided for by law. By this definition, all partnerships and companies with multiple distinct shareholders or members could be joint ventures, which is not the commonly understood meaning. Rather, joint ventures tend to refer to those associations (typically private) comprising a relatively small number of otherwise unrelated parties, each of which brings something of substance (capital, know-how, market access, etc) and participates actively in the management of the shared enterprise.

Working together and creating value: an alternative to going it alone and traditional M&A

Over the past century, joint ventures have been used for large-scale projects and in capital-intensive industries such as energy, infrastructure, pharmaceuticals, aeronautical engineering and telecommunications. More recently, joint venture techniques have been deployed to create legal structures for alternative private investments into asset classes such as real estate, infrastructure and private equity. Irrespective of the application, joint ventures allow for the pooling of resources and the sharing and reduction of risk with the potential to create value that would otherwise be beyond the reach of the parties independently of one another.

Issues to consider at the outset

Competition risks

Some of the key issues when setting up a joint venture for whatever purpose relate to competition law. One example stems from provisions for the sharing of commercially sensitive information or business secrets among joint venture partners who may be competitors. This is of particular concern in joint ventures where one party (for example,

the strategic partner) contributes technical expertise or market knowledge, especially in relation to pricing. Commercially, such parties will wish to guard against the use of such information to undermine their competitive position. Conversely, competition authorities will have the corresponding concern that such information should not be used to undermine market competition. Execution risk arising from merger controls is touched upon below.

Security and political sensitivities

The use of joint ventures to acquire a degree of control over an asset, without effecting a full acquisition, is an increasing cause of concern for governments and regulators. The strategic and political anxiety arising from foreign investors acquiring stakes in defence-related and other critical national infrastructure assets has led to more protectionist policy agendas in many parts of the world, including Australia, France, Germany, the United Kingdom and the United States. This has led, in turn, to governments seeking reinforced powers to screen and block foreign investments, including those structured as joint ventures.

Structuring considerations

The forming of a joint venture is nearly always influenced by tax and accounting considerations and, increasingly, by other factors including access to investor protections such as bilateral or multilateral investment treaties. The significance of the parties' respective operations, that of the joint venture and the degree of horizontal or vertical integration are all factors relevant in determining whether merger controls are triggered by the formation of a joint venture. Parties' control over the strategic direction and management of a joint venture will also affect the treatment applied by competition authorities.

Operations in practice

Joint venture partners should agree at the structuring stage how they wish the joint venture to operate in practice. In particular, how much of a free rein management should enjoy and the levels of control afforded to the various parties are critical questions demanding careful consideration at the outset. Including well-thought-out strategic and operational management provisions in the governing documentation will be a major determinant of success. Where visions diverge, deadlock can be a significant issue if appropriate controls and resolution mechanisms are not provided for in the joint venture documents. If deadlock cannot quickly be resolved, a joint venture may become paralysed and risk failing in one way or another. Conversely, if an effective mechanism is contemplated up front, deadlock can be resolved quickly, albeit potentially by means of the dissolution of the partnership.

A relationship first

Ultimately, joint ventures only survive so long as the joint venture parties wish them to.

Prior to establishment, it will often be difficult for parties to know whether a joint venture is the best way to proceed with a particular

endeavour. The chances of establishing a successful joint venture can improve with the following strategies:

- Joint venture parties should share complementary objectives. This does not necessarily mean that both parties should share the same objectives, but they should dedicate time and effort to understanding and making provisions reflecting their shared objectives and any tensions identified between them.
- All the parties to a joint venture should benefit from the shared enterprise. It is not necessary that all parties benefit equally, but it is important that they strike a fair bargain so that no party feels short-changed by the relationship. In certain circumstances, having a dominant party may be an advantage (for example, if one party has a particular skill and another has the funds and resources). It is important in these situations that any expertise contributed by a minority party is sufficiently protected and compensated. Otherwise, the dominant party may only choose to be part of the joint venture for so long as it needs to absorb the necessary experience or funding.
- At least one party should have experience in operating a joint venture. Studies show that the greatest indicator of a successful joint venture is prior experience.

Fail to prepare, prepare to fail

It is commonly observed that a great many joint ventures fail, and that the majority of failures occur in the first three years of a joint venture's life. This risk can be mitigated by dedicating sufficient planning and resources to the establishment of a joint venture, in particular creating a clear governance structure that allows a collaborative and open operating environment. Such prior planning will go a long way to ensuring that a joint venture will continue for so long as the parties desire. Where joint venture parties' interests can be aligned, expectations understood and care taken to create an equitable balance between the joint venture parties, then pursuing a business activity through a joint venture has the potential to yield rewards greater than the sum of its parts.



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