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August 10, 2010

International Joint Ventures: An Overview

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Joint venture arrangements are a common and sometimes practical or necessary alternative to M&A transactions to allow a company to expand into new markets. The following article provides an overview of key considerations with respect to international joint ventures.

One mode of entry for U.S. companies into international markets, or for non-U.S. companies into U.S. markets, is through a joint venture ("JV"). With a JV, the risks, costs, management and success of the venture are shared by the partners. The JV is one of the most common and effective means of conducting business internationally.

In a typical JV, two or more companies agree to share capital, technology, human resources, risks and rewards in the formation of a new entity (e.g., a corporation, general partnership, limited partnership, or limited liability company) under shared control. Potential benefits of an international JV include entering into related businesses in new geographic markets, exploiting opportunities that have a relatively short time span, and expanding into new markets and obtaining expertise.

International joint ventures are subject to many statutes, regulations and legal requirements. The overseas partner, the U.S. partner, lawyers, investment bankers and any other professional advisors must understand these requirements and the complex business considerations that must be satisfied. Informed guidance is essential.

In some cases a foreign partner may be required by law (e.g., in mining, manufacturing and telecommunications operations, where host countries often require 51% or more of the operations to be

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owned by nationals of that country). In other situations, foreign economic policy may make foreign ownership and/or control the most prudent alternative. A foreign partner typically brings knowledge of its domestic market, familiarity with government bureaucracy and regulations, and an understanding of local labor markets. The possibility of joining with another company in a new JV usually lowers capital requirements relative to going it alone.

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Background Research

Once the decision has been made to establish an international JV, it is imperative to create a country profile to gather information about the opportunities and risks involved in engaging in the type of business being contemplated. This profile will assist in deciding whether to do business and how to enter that country's market. It should provide the tools for assessing whether a particular venture makes business sense. The profile should include tax, labor, economic, political, industry-specific and legal information.

Additionally, it is prudent to identify and select a JV partner based on market research, evaluation of options, negotiations, business valuation, business planning and due diligence (financial and legal). It is important to determine the other party's financial condition, the identity and percentage ownership of the actual shareholders or partners, the background and existence of any political scandals or bribery, experience in the proposed business and ability to bring to the JV what the other party claims.

Finally, a detailed business plan should be prepared and may include, but is not limited to, an evaluation of the most appropriate JV business structure, general business purpose, operating policies, responsibility of the partners, objectives (with some tangible statements) and the goals of time, product line and geographic market applicable, sales volume, capital requirements, reinvestment and return of investment.

Legal Considerations

In non-bid situations, potential JV partners often enter into a Memorandum of Understanding/Letter of Intent ("LOI") with respect to the proposed transaction. The level of detail and content of the LOI varies widely, but typically outlines ideas with respect to the terms of the JV agreement. In almost all cases the LOI will not commit the parties to consummate a transaction, although it may commit them with respect to expense-sharing, confidentiality and exclusivity during the negotiations. Exclusivity provisions should be entered into and drafted with extreme caution and care, given that the failure rate in these types of negotiations is high and the freedom to pursue the opportunity with other partners without significant time delays or other considerations is valuable.

The JV agreement forms the basis of the understanding between the parties. It ensures that the parties understand their roles, rights, responsibilities and remedies in the conduct of the venture. A key to developing a good JV agreement is to determine one's goals and objectives in advance and ensure one's interests are reflected in the JV agreement. The JV agreement should include, without limitation: choice of entity structure, tax consequences and related matters, limitation of liability provisions, restrictions on foreign participation as an investor (if applicable), capitalization requirements (amount, timing and type) and related matters, corporate governance structure and decision making control, technology transfer provisions (if applicable), restrictions on competition (if any), transferability of ownership interest restrictions (if applicable), termination options, dispute resolution mechanisms and governing law and forum selection.

Examples of ancillary agreements that may be central to the JV include a lease of real property (i.e., terms between the JV parties and the JV), technology licensing agreements, marketing agreements, trademark agreements (parties' rights to use trademarks), or a management services agreement (facilities management, plant services, bookkeeping, etc.) that may provide the partner with technical expertise or a preferred supplier agreement. Negotiations of ancillary agreements are as important as those for the JV agreement and may often be as difficult and time-consuming.

U.S. Companies

U.S. companies can find it very disadvantageous to rely upon their potential foreign JV partners to negotiate host government approvals and advise them on legal issues, since their prospective partner's interests may not always coincide with their own.

The U.S. company's legal counsel should locate and engage smart, reliable, responsive, experienced, English-speaking local counsel. U.S. lawyers experienced with international commercial law and international JVs typically have many such contacts. Local counsel should already be familiar with all applicable laws and regulations.

Before local counsel is engaged, a conflict-of-interest check should first be performed by the local counsel being considered for engagement (with the local counsel confirming in writing it has no conflict) and billing rates should be determined, as well as an understanding and requirement that itemized bills will be sent regularly at reasonable intervals (with bills potentially payable in U.S. currency).

Foreign partners may want to form a JV based upon a handshake or an extremely brief and vague agreement. It is a common negotiating tactic to assert local custom, practice and (sometimes) law as a basis for omitting many provisions that are typically found in U.S.-style documents.

Local counsel should be able to help a U.S. partner sort out these issues. The U.S. partner and its legal counsel should negotiate a clear, concise and comprehensive agreement so the parties fully understand what they are doing and the consequences of their actions.

Qualified local counsel can be very helpful in obtaining government approvals and providing ongoing advice regarding the host country’s intellectual property, tax, labor, corporate, commercial, antitrust and exchange control laws.

Even if a choice of forum clause is enforceable, the resulting foreign judgment may not be. Furthermore, equitable relief, which may be the only effective remedy, may not be available, or available only in limited circumstances.

Non-U.S. Companies

Non-U.S. companies can find it very disadvantageous to deal with potential U.S. JV partners without the assistance of experienced and competent U.S. legal counsel. U.S. legal counsel should have experience with international commercial law and international JVs. Qualified U.S. legal counsel for non-U.S. entities can be helpful in obtaining government approvals, where necessary, and such law firms frequently have U.S. government lobbyists and U.S. government contacts. U.S. legal counsel for non-U.S. entities can advise their non-U.S. clients with respect to the need for and implications of U.S.-style documents proposed by the potential U.S. JV partner and what is “market,” so there is no overreaching.

Regulatory Approvals

JVs can raise U.S. or foreign antitrust issues in certain circumstances, particularly when the prospective JV partners are major existing or potential competitors in the affected national markets. A U.S. Hart-Scott-Rodino filing may be required with the formation of a corporate joint venture, depending on its size, unless a relevant exemption applies. U.S. companies may wish to consider applying for an export trade certificate of review from the Department of Commerce or a business review letter from the Department of Justice when federal antitrust issues are raised by the proposed international JV. Attention must be paid to other U.S. laws related to international transactions, including, without limitation, the Export Administration Act*, the Foreign Corrupt Practices Act (15 U.S.C. Section 78dd-1 through 78ff), the Travel Act (18 U.S.C. Section 1952), and the Exon-Florio Amendment (50 U.S.C. App. Section 2170).

Alternatives to Forming a JV

Two alternatives to forming an international JV include acquisition and entering into various foreign agreements. Issues to consider for an acquisition as opposed to a JV include looking at potential comparative synergy (integration of new resources and capabilities), feasibility (market entry fee, both financial and non-financial), digestibility (post-acquisition integration costs) and commitment (flexibility versus value). Additionally, instead of forming a JV, an entity might instead decide to enter into a foreign sales representative agreement, foreign distribution agreement, a foreign license agreement, a foreign supply or manufacturing agreement or a combination of any of the foregoing.

Conclusion

In forming an international JV, best practices dictate that one needs to:

1. Gather information about the opportunities and risks involved in the type of business contemplated.

2. Identify and select an appropriate international JV partner.

3. Prepare a detailed business plan.

4. Retain experienced professional advisors who can provide informed guidance regarding relevant statutes, regulations and legal requirements, and assist in drafting and negotiating the JV LOI and JV agreement.

By following these simple guidelines, a company that desires to expand into a new geographic market can greatly enhance its chances for success.

*The Export Administration Act of 1979, as amended, has been in lapse since August 21, 2001. In the absence of the Export Administration Act, the U.S. dual-use export control system continues to be dependent on the President's invocation of emergency powers under the International Emergency Economic Powers Act.

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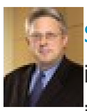

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