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COMMENT: REPRESENTATION OF JOINT VENTURES:

A PRACTICAL PERSPECTIVE FROM IN-HOUSE COUNSEL

Wendy C. Shibat†

Thank you for the opportunity to provide comments on today's presentations. As a member of the in-house bar, I will be speaking for those of us who bridge the gap between what we have heard today from the outside practitioners and the needs of the business team. My comments today fall in two categories. In one set of comments, I will compare and contrast observations we have heard from all the speakers, based on my perspective as an in-house counsel. I will also draw some practice pointers for members of the audience who are primarily in outside practice.

The first thing that we have heard about from several speakers today is the marriage analogy. We have been told that a joint venture can be a prelude or a courtship period leading up to a commitment to make it permanent through a merger or an acquisition. Those of us who are married know that integration issues are very challenging in the marriage relationship. As a prelude to marriage, when we enter the courtship phase, the partners typically are assessing their compatibility before they decide to go forward with the marriage. In contrast, many strategic alliances are successful in formation because the entities come together with contrasting styles and cultures, which is a deliberate choice on their part. In the pharmaceutical and research and development example we heard about earlier, the research and technology component of the joint venture benefits from the entrepreneurial drive of the research partner, whereas the marketing and distribution component seeking channels to market often derives its strength from the more well-established partner with more traditional values.

Dan Austin observed that joint ventures enjoying the longest duration and longevity often are comprised of complimentary part-

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ners. But that same joint venture between complimentary partners faces considerable challenges if it is intended to be the first step leading ultimately to a permanent relationship between the parties. We often see this theme play out in the arena of global joint ventures. Our speakers have said that global joint ventures are often formed because the domestic partner cannot go it alone in a foreign jurisdiction. When entering into this kind of relationship, it is important to plan at the outset whether the long-range goal is, in fact, to have the joint venture continue to run independently for as long as it is mutually beneficial to both partners. It is quite another thing to see the joint venture as a prelude to an acquisition where integration is the ultimate goal. The contrasting cultures and values may work well together initially, but that synergistic, complimentary relationship could prove to be a disaster once you try to make it a permanent relationship.

Another theme explored by the first panel this morning was the impact of joint ventures on changes of control. Steve Fraidin commented on the potential for change-of-control clauses within the joint venture relationship to actually reduce the value for one of the joint venture partners, its shareholders, and the ultimate takeover scenario. Consequently, it is critical for those of us who conduct acquisition due diligence, whether in the hostile or negotiated context, to examine change-of-control clauses in existing joint ventures to which the target firm is a party to determine whether the anticipated value is actually going to be realized. Oftentimes, the joint venture parties want very clear and strong change-of-control clauses so that they will be in the driver’s seat if one of those events should come to pass. Yet we should guard against the possible unintended consequence of a favorable takeover or acquisition situation that would, in fact, strengthen the joint venture partner and yet be prohibited by a change-of-control clause. I suppose the easy answer is that it is within your control because you always have the right of waiver. For that reason, I cannot imagine that a joint venture partner would want to forego having a change-of-control clause in the first instance, but it should be mindful of the potential for unintended consequences.

As a practice pointer, I note the importance of having the due diligence team feed information directly and in a timely fashion to the negotiating and drafting team. It is critical for the due dili-

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1 See Daniel F. Austin, A Businesspersons' Perspective Concerning Joint Ventures, 53 CASE W. RES. L. REV. 905 (2003).
gence team to be on the alert for change-of-control triggers throughout the documentation, because by doing so, the negotiators have opportunities to deal with them. For instance, it might be possible to structure the transaction so as to avoid the change-of-control trigger. Failing that, you might negotiate conditions subsequent to make certain that your party’s expectations are realized through obtaining waivers or governmental approvals, or whatever else may be necessary. Or, you might have to work out some sort of a variable pricing clause, because, as Steve Fraidin pointed out this morning, the value to the other party may be very different depending on the effect of the change-of-control clause.\(^3\)

Turning to another topic, we have heard much about the fiduciary duty issues presented by strategic alliances. I want to echo everything that I have heard about the challenges, not only for the management directors of the equity joint venture, but also for outside counsel. Jeanne Rickert pointed out the conflict that can exist between representing the interests of the joint venture versus those of the partners.\(^4\) She said this could be somewhat ameliorated by designating the business people as representatives of their respective firms.

The business people generally perceive their role as maximizing the interests of the partners they represent, even though legally they are supposed to be serving the individual entity. In my experience as counsel to joint ventures and from sitting on joint venture boards, I think it is accurate to say that the director is in the schizophrenic role of trying to wear dual hats. But the reality of the situation is that the directors perceive their primary obligation as belonging to the partner whom they represent. This is a thorny issue that has yet to be addressed in an underdeveloped body of law governing joint ventures and strategic alliances.

The practice pointer that I would draw is that, to the extent possible, it is helpful to bifurcate the meeting. In global alliances, for example, the members of the governance structure tend to meet infrequently in a very stylized form, perhaps only once or twice a year. To avoid using the formal board meeting as the forum for discussion of operating issues, it is helpful to precede the meeting with an operations review presented by the day-to-day managers of the venture. The directors can then ask questions and receive information wearing their hats as the economic investors in the joint venture. By conducting an operations review outside the confines

\(^3\) Id. at 889.

of the formal board meeting, the directors become more free to act on behalf of their respective business interests.

Through the use of operations review sessions, much of the discussion leading up to a decision takes place outside the formal board meeting, and consensus begins to emerge. Then, you can document the formal decisions taken by the directors during the official meeting. It is often easier to separate the roles of these individuals when it is done in such a manner. I really do question whether it is humanly possible for directors to act solely on behalf of the joint venture to whom they owe the fiduciary duty without having the interest of the partner in mind and, perhaps, first in mind.

I want to turn next to the role of the attorneys representing strategic alliances. We heard from Dan Austin, one of the few non-lawyers on the panel today, who advised that our critical role is to help our clients obtain clarity on what they want to achieve through the joint venture and to identify the contingencies.\(^5\) I would add to Dan’s advice the need for vigilance at the deal-making phase, when attorneys believe that our goal is to promote the business interests of our clients and to bring the transaction to fruition. Remember that as counselors, we can play an invaluable role in giving our clients the fortitude and courage to walk away from a bad deal. Very often, you will see a transaction develop quite a bit of momentum, but as you get into it, either through due diligence, negotiation, or trying to better document the parties’ expectations, you realize that the deal is flawed. Now, as lawyers we do not substitute our business judgment for that of the principals, and we do not want to be known as deal killers, as we sometimes are. However, I think we can counsel our principals to understand that not every deal deserves to close.

Virtually all of the speakers discussed the importance of focusing on the planning role (versus the adversarial role) that attorneys can play in helping parties articulate their goals. My hypothesis is that in-house counsel performs this role more efficiently than outside counsel does. If you read Professor George Dent’s paper and his materials, you will see that part of his hypothesis is that those of us who are in-house may not be best situated to negotiate the deal because we are a part of the management team.\(^6\) To be sure, it is very difficult for us not to cross that line between being a trusted advisor and exercising business judgment. George also believes that we could succumb to the pressure of the

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\(^5\) Austin, supra note 2, at 907.

senior management team because we know how much they want the deal to be done.\textsuperscript{7} He also suggests that we do not have the same breadth of experience as outside counsel.\textsuperscript{8}

I would submit that in a major deal you really have to have both, and that in-house counsel have insights that are difficult for outside counsel to achieve. As inside advisors, we have access to members of management who are absolutely critical, not only to documenting and negotiating the venture, but also to operating it on a long-term basis. It is important to get the operations and financial people involved in testing the words that you put down on paper. You need to actually run numbers through the verbal formulations, do pro formas, and run sensitivity analyses to see whether these written clauses are going to produce the financial results that your principals actually expect. Examples of where this can be crucial include transfer pricing clauses and buyout terms.

To avoid the criticism often leveled at the lawyers, George also pointed out the need for early involvement, because when we come in at the tail end, we start asking all these tough questions and the deal already has so much momentum that the principals are going to look to the lawyers as being the problem.\textsuperscript{9} It is much easier when you are in-house to be involved at the front end. You are naturally involved in business discussions, and you do not have to ask to be invited to the table because you are already there.

I would like to suggest ways for outside practitioners to get to the party a little bit earlier in the process rather than coming in after there has already been a handshake deal. A lot of this comes down to the fundamental economics of how we practice law today. We all talk about alternative billing. You on the outside talk about it because we on the inside as clients are demanding it. We want more efficient services at lower costs, and so we ask about alternative billing. Yet in my experience, we always revert to the benchmark of billable hours because we both want to know at the end of the day whether it was a better deal for us or for you.

To become invaluable as outside counsel, consider getting to know your client’s business on a very pragmatic level. Do it on your own nickel, not as part of your billable hours that are going to show up in the monthly bills that I review. You can do this through meeting with junior people in management with whom

\textsuperscript{7} Id. at 57.
\textsuperscript{8} Id.
\textsuperscript{9} George W. Dent, Jr., The Role of Lawyers in Strategic Alliances, 53 CASE W. RES. L. REV. 953 (2003).
you would not ordinarily have contact. You can do it through facility tours, by visiting plants and manufacturing facilities. You can do it by surfing their web sites, which have a wealth of information. Think of it as an investment on your own dime. I think I said nickel before, so I just doubled the rate, the amount of your investment.

Another creative billing approach that I have used successfully is for outside counsel to charge discounted hourly rates at the developmental and planning stages. Counsel will benefit from being on board at the very beginning and knowing what is on our mind and what we hope to gain from the venture. And you will have demonstrated that you are willing to ride along with us and share in the risk. If the deal moves forward, we agree that we will pay you either a premium over your regular billable rate or a success fee. The client then knows that you are willing to partner with them and you, in turn, will become a much more valuable member of their team. All in all, I would suggest that you get much more creative in offering a value proposition to your clients.

Finally, I observe that in discussing choice of structure, several of our speakers said that they are seeing much more use of the equity joint venture, the formalized structure. In my experience, we do not necessarily have an equity joint venture on the one hand, or a contractual relationship on the other. I have worked with several entities formed with equity infusion by both partners and extremely detailed operating agreements. So, it has been a hybrid model. In the ten years that I have been in the manufacturing sector, I have observed a growing degree of fatigue on the part of senior management in managing the complexities of equity joint ventures burdened with complicated operating agreements. And now I am seeing an emerging trend of seeking alternatives that permit swifter and more nimble behavior in getting the development done and the product to market, such as licensing arrangements. Having said that, I do agree with Sanjiv Kapur that the equity joint venture provides a definitive mechanism for accounting, not only for profits, but also for auditing the relationship. Audits serve a dual function of monitoring the operating partner’s conduct and validating business expectations in entering into the joint venture.

George, I believe I will stop now so that we can go forward with some group discussion. Thank you very much for inviting me to participate today.

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