Collas Crill explains... Joint ventures

July 2021

This is part of a series of guides in which we examine areas of law that frequently arise in practice. Further guides will be released weekly; click here to subscribe to receive Collas Crill news and insights by email.

Understanding joint ventures

Joint ventures are common legal structures used when two or more parties look to cooperate and combine their skills, resources and capital towards a common goal.

Despite what might seem a simple and straightforward arrangement, no two joint ventures are ever the same. Each come with their own set of dynamics between the venture partners, requirements for the joint venture vehicle and business, peculiarities of the parties (and their respective histories or group structures), as well as many other facts and circumstances. Suffice to say, getting a joint venture agreement fit for purpose can often take more time and thinking from the two commercial teams than it does in the drafting. Should one move to the drafting too quickly, the gaps in the commercial arrangements or understanding can be quite costly (either in drafting costs or, heaven forbid, remediation costs at some point down the line).

Governance

Perhaps the most obvious issue is one of governance between the joint venture partners. Often negotiations begin on the assumption that the joint venture vehicle will be owned 50-50. While this may sound sensible commercially, it is rare that both parties bring the equal contributions to the table and, as anyone with parents would know, two parents can be just as much a blessing as they can be a curse.

Sometimes it's preferable to have one party with some level of control, subject to veto rights by the minority partner, rather than everything dividing along 50-50 lines leading to potential deadlock.

Whether the control is split 50-50 or not, key elements to consider are as follows:

Board composition

This is key and includes how many representatives from each venture partner, and whether any independent directors, will be on the board. The parties may also wish to appoint observers for board activities who do not have a vote but are entitled to attend all meetings. Consideration should also be given as to the mechanics for calling board meetings, quorum for such meetings as well as chairmanship. Whilst these matters may seem innocuous, a poorly drafted set of provisions could inadvertently allow a minority party to push through a proposition that is not welcomed by their partner. Whilst this is something that could be undone perhaps, it's not an ideal scenario so forethought on these provisions is suggested.

Information rights

The agreement would ordinarily describe in some detail the rights of any observer and the respective shareholders to information and reports from the joint venture vehicle. This is important because shareholders' information rights are much more restrictive than those of board members. To avoid issues of conflicts of interest for the appointed representatives on the board, it is advisable to include specific information rights provisions for the shareholder parties.

Reserved matters

This refers to those matters of business which require the consent of both venture partners, notwithstanding the composition of the relevant board or shareholdings. This is all generally limited to significant matters which would fundamentally change the business or nature of the originally intended venture, such as a sale of the business, an unexpected acquisition or similar activity. An often overlooked element of this is the venture parties agreeing a robust and specific business plan. This is appended to the joint venture agreement but is often only described in short form in accordance with the 'casual' commercial agreement between the parties. This is a mistake. The business plan is a key driver of the venture and must be drafted with close involvement of the commercial parties. It is not something that can, or should, be left to the lawyers to sort out.

Finally, a clear articulation of how a *deadlock* or dispute between the parties is to be resolved should be considered. This must take account of the respective contributions of the parties, both in terms of resources and capital as well as the nature of the underlying business and with whom final decision should rest. A fast, practical approach is recommended such that deadlocks don't become protracted in nature.

Clarity on contributions

Joint venture partners provide valuable contributions to the new business in a number of ways. This can be equity capital, human capital, access to clients and markets, access to valuable intellectual property, to name just a few. Where the contribution is not by way of cash, and even in this circumstance, a clear articulation of the nature of that contribution, the timing of that contribution and the understanding between the parties as to how that may change over time is best set out in the agreement or the business plan. A poorly executed joint venture arrangement relies on some form of "we know what we mean and it will be fine" arrangement between the parties. In our experience "we know what we mean" often means two different things...

Transfers and further funding requirements

Finally, and to be fair something that is commonly executed correctly, the agreement should make clear the ability of either party to transfer their interests or sell their interests to third parties. Most commonly the non-exiting party will have a preemptive right to acquire the relevant interests and other protections to avoid unwanted pairings with new parties. Similarly, the joint venture agreement should make clear that where further funding is required it would ordinarily be offered to the existing shareholders on a preemptive, pro-rata basis to avoid dilution without consent.

Joint ventures are powerful and effective arrangements to allow commercial parties to work together and combine their various resources. Most importantly, the commercial plan between the parties will be different in every case and the agreement should be structured to reflect that and avoid unnecessary complications down the road (which, ironically, often only arise where the joint venture is a success and the value created is suddenly of particular interest.)

About this guide

This guide gives a general overview of this topic. It is not legal advice and you may not rely on it. If you would like legal advice on this topic, please get in touch with one of the authors or your usual Collas Crill contacts.

About Collas Crill

We are a leading offshore law firm. We are easy to do business with and give practical advice to overcome tough challenges. Through our network of offices, we practise British Virgin Islands, Cayman Islands, Guernsey and Jersey law.

For more information please contact:

Paul Wilkes
Consultant* // Guernsey
t:+44 (0) 1481 734268 // e:paul.wilkes@collascrill.com

Wayne Atkinson
Partner // Guernsey
t:+44 (0) 1481 734225 // e:wayne.atkinson@collascrill.com

Simon Heggs
Group Partner *† // Guernsey
t:+44 (0) 1481 734825 // e:simon.heggs@collascrill.com

Gareth Morgan
Group Partner *† // Guernsey
t:+44 (0) 1481 734264 // e:gareth.morgan@collascrill.com