

January 11, 2012

RECENT TRENDS IN JOINT VENTURE GOVERNANCE

To Our Clients and Friends:

For the last decade, governance issues have been a priority at public companies and companies planning to go public. Recent joint venture activity reflects a carryover from the public company arena of this intense focus on improving governance. Venture partners are increasingly concentrating on developing and implementing governance best practices within their joint venture vehicles. This client alert provides a brief discussion of recent trends in joint venture governance.

Use of Public Company Governance Practices in Joint Ventures

Many joint venture planners are using or adapting governance practices developed by public companies to address public company governance concerns, including the following:

- ***Independent Directors.*** Some joint venture partners are agreeing that their venture's governing board will include not only directors appointed by and representing each of the venture parties, but also independent directors (*i.e.*, directors who are not affiliated with any joint venture partner). The addition of independent directors, which is most frequently seen in large joint ventures or ventures with multiple parties, is often intended to address one or more of the following objectives: (1) providing an independent perspective to help resolve conflicts that may arise among the parties; (2) providing technical, business, management or capital raising expertise the venture partners do not have; (3) representing the collective interests of smaller partners whose individual ownership stakes do not entitle them to appoint their own representatives to the board; and (4) elevating the stature of the joint venture if the independent directors are recognized as experts in the joint venture's industry or are prominent members of the community in which the joint venture does business. In some cases, when the joint venture partners recruit an outside manager to run the venture, they will give the outside manager a board seat, and this manager fills the role of an independent director.
- ***Committees.*** Like public companies, joint ventures with large governing boards are establishing audit, compensation and other board committees to make board decision-making processes more efficient. Joint venture partners may also use committees to resolve conflicts of interest among the venture and its partners, or between the venture and members of its management team. In addition, joint venture partners establish committees to help allocate decision-making authority among partners; a partner that is entitled to have board representatives appointed to a committee will have a voice in, and may even be able to control, the decisions made by the committee.
- ***Conflicts of Interest and Codes of Conduct.*** Partners negotiating joint ventures are spending increasing amounts of time developing codes of conduct and policies regarding conflicts of

interest. These codes and policies are intended to legislate how business dealings between the joint venture company and a venture partner or its affiliates will be conducted and define the rights and responsibilities of the joint venture company and the venture partners regarding corporate opportunities. They often reflect the nature of the industry in which the particular joint venture will operate. In technical joint ventures, for example, the focus of conflict of interest policies is often the ownership, use and commercialization of intellectual property rights.

Joint venture planners who intend to use public company governance practices should be aware, however, that governance concerns at public companies can be very different from those at joint ventures. As a result, solutions developed to address public company governance concerns will not necessarily be appropriate for a joint venture company. Understanding the differences in the governance issues faced by public companies and joint ventures will help joint venture planners determine whether public company governance measures can effectively resolve the joint venture's governance concerns.

- ***Differences in the Role of the Governing Board.*** Because the role of the board of directors of a public company is not directly analogous to the role of the governing board of a joint venture, various safeguards that are widely used by public companies may not be necessary in the joint venture context. Other than voting for directors, stockholders of a public company generally do not directly participate in managing the company. Instead, the board of directors acts on behalf of a disaggregated body of stockholders. As such, a public company board has the principal responsibility for overseeing the development of the company's business strategy and the implementation of this strategy by company management. Independent directors, board committees and codes of conduct are vital tools that help ensure informed and efficient decision-making. They also protect the public stockholders from self-dealing by insiders. In a joint venture, by contrast, the governing board members typically represent a small number of partners. The venture partners generally have representatives on the board, and the board develops and implements the venture's business strategy based on direct input from the owners. The principal governance problem most ventures face is the need to mediate disputes among the owners and help them to reach appropriate compromises as necessary. The governing board typically serves that purpose. Independent directors, committees and codes of conduct can also be helpful tools in this context, but they should be used in a way that takes into account the specific needs of the venture.
- ***Fiduciary vs. Contractual Protections.*** Under applicable law, a public company board owes fiduciary duties to, and is charged with protecting the interests of, all stockholders, including stockholders who do not have leverage to negotiate with the company or other stockholders for special rights. The use of independent directors, board committees and codes of conduct provide critical support to the fiduciary protections afforded by law. The managing boards of joint venture companies also owe fiduciary duties to the venture partners under applicable law. But venture partners generally have a direct voice on the board. In addition, when they enter into the venture, they have the opportunity to negotiate specific contractual rights designed to protect their interests. In fact, in many circumstances, they will waive their common law or statutory fiduciary protections, relying instead on a set of negotiated contractual protections.

- **Differences in Conflict of Interest Problems.** A principal challenge faced by public companies is preventing directors, management and other fiduciaries from taking advantage of public company stockholders and diverting corporate opportunities from the public company for the benefit of the fiduciaries. Public companies use independent directors and committees and codes of conduct as mechanisms to prevent such self-dealing. Venture parties may also be concerned about breaches of duties by fiduciaries, and conclude that the standard governance tools developed by public companies are an appropriate way to tackle these problems. But as indicated above, venture parties' principal concern is likely to be balancing the goals of the joint venture company and the individual goals of the venture partners, and not stopping self-dealing. Again, although public company governance tools such as codes of conduct can be used to address this problem, they must be tailored to fit the circumstances.

Additional Trends in Joint Venture Governance Practices

- **Creativity in CEO Arrangements.** Rather than designating a chief executive officer in the venture documents or delegating authority to the governing board to select a chief executive officer, joint venture parties are experimenting with a variety of alternative arrangements, such as:
 - each venture partner appoints a CEO to serve contemporaneous or overlapping terms as co-CEOs;
 - the venture partners take turns appointing the CEO, who serves for a single term; and/or
 - each venture partner appoints one or more specific senior officers, *e.g.*, one partner appoints the CEO and the other selects the chief financial officer.

These arrangements have fairly obvious drawbacks. Parties choose these alternatives because they believe the advantages of a more powerful voice in daily management outweigh the disadvantages. While the arrangements are typically used in a joint venture between two members, they can also be adapted for use in a joint venture among more than two members.

- **Use of Technical Committees.** Joint ventures, particularly technology and manufacturing ventures, are increasingly using special committees to focus on technical issues and resolve related disputes. Delegating responsibility for resolving disputes over technical matters to, or seeking guidance from, a committee whose members have specialized knowledge may promote efficient resolution of the disputes and ensure that technical issues receive appropriate attention. The technical committee can also be used to give individual partners a greater voice on matters in which they have particular interest. If the dispute is not resolved in a timely manner, the joint venture agreement may provide for resolution by the same method as other disputes arising among the parties, *e.g.*, by directing senior executives of each partner to seek to resolve the dispute and, absent resolution, then resorting to arbitration. Technical committees can also be used to coordinate communication between the venturers' respective technical staffs or

GIBSON DUNN

oversee technical projects of the venture. Members of a technical committee generally include representatives of each venture partner, and may also include independent members with subject matter expertise. Venture parties can tailor the committee's schedule and structure to best serve the venture's needs, *e.g.*, by requiring regular meetings or only meeting as necessary.



Gibson, Dunn & Crutcher lawyers are available to assist in addressing any questions you may have regarding these issues. Please contact the Gibson Dunn lawyer with whom you work or any of the following:

Stephen I. Glover - Washington, D.C. (202-955-8593, siglover@gibsondunn.com)

Jeffrey A. Chapman - Dallas (214-698-3120, jchapman@gibsondunn.com)

Jonathan K. Layne - Los Angeles (310-552-8641, jlayne@gibsondunn.com)

Robert B. Little - Dallas (214-698-3260, rlittle@gibsondunn.com)

Alisa Babitz - Washington, D.C. (202-887-3720, ababitz@gibsondunn.com)

© 2019 Gibson, Dunn & Crutcher LLP

Attorney Advertising: The enclosed materials have been prepared for general informational purposes only and are not intended as legal advice.