

Take Me To Your (Joint Venture) Leader

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A critical factor in the success of a joint venture, like any business enterprise, is the effectiveness of its executive leadership. As a result, venture parties take very seriously the question of how the CEO and other senior executives of the venture will be selected. There is a range of potential answers to this question, as described below. The challenge for the venture parties and their advisers will be to select an approach and adapt it, as need be, to suit their particular circumstances.

Different approaches to CEO and executive selection include:

- **Joint Selection:** Each venture party must approve the selection of the CEO and other executives of the venture company. The venture parties work together closely to identify and agree on the persons appointed to each position. If the joint venture has more than two members, this approach can be modified to require approval by a majority or supermajority of the venture parties, or venture parties holding a specific amount of equity in the venture company.
- **Veto:** One venture party selects the CEO and/or other executives of the venture company, but the other venture party has the right to veto any of the proposed candidates. This approach is very similar to the "joint selection" approach above because the parties must ultimately agree on the executives selected. If the joint venture has more than two members, they must decide whether any, or only certain, "nonselecting" venture parties can veto a candidate.
- **Selection by the Board:** The board or other governing body of the joint venture selects the CEO and other executives. The joint venture parties appoint the board members, but otherwise do not have a formal or official role in selecting the CEO and other executives (depending on the circumstances, a venture party may be able to indirectly control or influence executive selection by acting through the venture party's board representatives).
- **Selection by One Venture Party:** One venture party selects the CEO and may also have the right to select other specifically identified executives of the venture company. Another venture party



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has the right to select a different set of specifically identified executives, such as the chief financial officer or general counsel. No venture party has the right to veto selections of the other venture party.

- ***Alternating Venture Party Selection:*** This approach, which is chosen less often than those listed above, is similar to the "selection by one venture party" approach, except the venture parties take turns selecting the CEO, who will serve a prescribed term. For example, one venture party selects the initial CEO for a two-year term. The second venture party subsequently selects the second CEO, also for a two-year term, and so on. If other executives are also selected in this manner, the parties may decide to stagger the length of their terms to provide for some continuity of senior management.
- ***Co-CEO Arrangement:*** The joint venture has two co-CEOs, each selected by a different venture party. This approach is also relatively less common. When it is chosen, the venture parties will need to determine the scope of each co-CEO's authority, including what decisions, if any, a particular co-CEO may make unilaterally, and what decisions, if any, require the approval of both co-CEOs. The venture parties will also need to decide whether to mandate how deadlocks between the co-CEOs will be resolved.

The approaches described above can be modified and/or combined in innumerable ways to meet the needs of the venture parties. Many joint ventures will employ at least two different approaches; one approach for selecting the initial executive team, the members of which are often identified in the joint venture formation documents, and one approach for selecting their successors. (As a practical matter, if the joint venture will operate an ongoing business immediately after the joint venture is formed, the venture parties will need to identify the executive team in the formation documents.)

For example, the venture parties may jointly agree on the identity of the initial CEO and executive team as set forth in the joint venture formation documents, and provide that the joint venture board will select all successor executives. Or the venture parties may agree that the joint venture will have co-CEOs for an initial period but once that period ends, the parties will jointly agree on a single CEO. Or, if the joint venture has several members, they may agree that the two venture parties owning the most equity in the venture company will take turns selecting the CEO and the CFO; however, if one venture party subsequently becomes the majority owner, it will have the sole right to appoint the CEO and CFO.

The approach(es) that make sense for any specific situation will depend on the applicable facts and circumstances, including the negotiating dynamics and the leverage of each venture party. Relevant factors may include, among others:

- ***The Number of Venture Parties:*** For example, a joint venture with a small number of venture parties may believe the "joint selection" approach will be the most straightforward approach to implement. A joint venture of this kind may also lend itself more easily to the "veto" approach or the "alternating venture party selection" approach. The "co-CEO" approach may work best with a joint venture with only two parties.
- ***The Venture Parties' Respective Equity Ownership of the Venture:*** For example, the "selection by one venture party" approach may make more sense when one venture party will be the majority owner of the joint venture and the other venture party or parties will hold much smaller, minority positions in the venture company. In contrast, if each venture party will have

the same amount of equity and the same governance rights, the equitable nature of the "joint selection" approach or the "selection by the board" approach may make them more desirable alternatives.

- ***The Respective Bargaining Power of the Venture Parties and the Tenor of the Negotiations:*** For example, a venture party with greater negotiating leverage than the other venture parties may be able to insist that it select the CEO. In contrast, if the venture parties have more or less equal negotiating leverage, they may agree on the "joint selection" approach. Difficult negotiations may result in more cumbersome approaches; for example, if the venture parties in a two-member venture are not willing to collaborate on CEO selection, they may employ the "alternating venture party selection" approach or the "co-CEO" approach.
- ***The Relationship of the Venture Parties to the Joint Venture Business and/or Experience in the Joint Venture Industry:*** For example, if one venture party has run the business that will become the joint venture business and the other venture party does not have experience in the joint venture's industry, the venture parties may agree that the experienced party can take the lead in choosing executives, and adopt the "selection by one venture party" approach or the "veto" approach.
- ***The Venture Parties' Respective Objectives With Respect to the Venture:*** For example, a venture party that intends to take a more passive role in the venture, or a venture party that joined the venture in order to exit the joint venture business over time, may be comfortable with the "selection by the board" approach or allowing the other venture parties to select the executives.
- ***The Form of the Venture Company:*** For example, the limited liability company form will give the venture parties significant flexibility to tailor the executive selection process to their needs. In contrast, fewer options may be available when the limited partnership form is used due to restrictions on limited partners' rights to control the limited partnership's business. In addition, a venture party that invests as a limited partner may not expect to have a significant voice in the selection of the executive team.

Ideally, the venture parties will select venture executives in a noncontentious manner, none of the venture parties will force arbitrary management changes, and all of the venture parties will work to achieve smooth management transitions. Viewed against this standard, approaches based on consensus, such as the "joint selection" and "selection by the board" approaches, seem preferable, and approaches that mandate change or create uncertainty about the chain of command, such as the "alternating venture party selection" and the "co-CEO" approaches, seem problematic. However, venture parties and their advisers should be aware that no single approach or combination of approaches will work well under every set of circumstances, nor is any single approach or combination doomed to failure. As noted above, the key to choosing the right approach or combination of approaches for a particular joint venture will depend on its specific facts and circumstances.

In addition to negotiating how the CEO and other executives will be selected, the venture parties may also spend time negotiating various related matters:

- ***Executive Qualifications:*** Regardless of the CEO selection approach employed, the venture parties may develop a set of qualifications that each executive must have, such as criteria

relating to education, industry background and expertise, as well as particular skill sets. Similarly, the venture parties may agree on other parameters that narrow the search pool, such as requiring that the executives currently work, or have worked, for one of the venture parties.

- **Relationship Between the CEO and the Board:** The venture parties may also seek to define the parameters of the relationship between the CEO and the joint venture board. For example, the joint venture agreements may specify whether the CEO will be a member of the board and, if the CEO is a board member, whether there are certain matters on which the CEO cannot vote, such as whether to call additional capital from the venture parties. In addition, the venture parties often seek to restrict the executive team's authority by developing a long list of matters that require board consent, such as incurring debt above specified thresholds, entering into certain contracts, placing certain liens on venture assets, etc. Depending on the thresholds used in these lists and the size of the joint venture, these board approval requirements may be seen as interfering with the ordinary business of the venture company and the executive team's ability to run the joint venture business. However, these restrictions help ensure that the venture parties, through their board representatives, have a voice in the direction and operation of the joint venture. Finding the right balance between these competing considerations may be difficult, but the venture parties and their advisers should keep both in mind when developing the list of matters that require board consent.
- **Removal:** In addition to selecting the CEO and other executives, the venture parties may also legislate who can remove the CEO and other executives. For example, this authority can be delegated to the board, exercised by a majority, supermajority or unanimous decision of the venture parties or reserved for the venture party that had the right to appoint the CEO or other executive.
- **Transferability of Rights:** If a venture party has rights to transfer its equity in the venture company, the venture parties must also determine whether any rights the transferor has to select and remove the CEO and other executives are also transferable, and whether such transferability depends on various factors, such as whether the transferee is a third party, another venture party or an affiliate of the transferor.

The executive selection approach ultimately used in any particular joint venture will be the product of the unique circumstances and deal dynamics of that joint venture. The factors that influence this decision will also affect related matters, such as removal of venture executives. When designing the approach for their joint venture, the venture parties and their advisers should consider not just their current circumstances and relationships, but also how such factors may change over time. As illustrated by some of the examples above, different approaches can be combined and/or modified to accommodate any number of situations.

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