S.11 INTERNATIONAL JOINT VENTURES FOR RESEARCH AND DEVELOPMENT

STRUCTURING AND NEGOTIATING INTERNATIONAL JOINT VENTURES FOR RESEARCH INVOLVING U.S. ACTIVITIES

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Learning Objectives

- Learn about joint venture structures, regulatory issues, preliminary agreements, and related agreements
- Outline of a typical joint venture agreement (parties, governance, financing, disputes, intellectual property issues, separation and termination)
- Discuss additional issues, such as government approvals, taxes, due diligence, expatriates and political risk insurance
International joint ventures come in a multitude of sizes and shapes

- Partnership/LLC/LLP
- Corporation
- Contractual (non-equity)
  - Either be a co-ownership model or simply a contract between the parties whereby they retain all their own assets and agree as to their separate rights and obligations
  - “Partnering” arrangements, strategic alliances and outsourcing services arrangements
Scope/Purpose of the JV

- What activities does the JV intend to do or refrain from doing
- Corporate opportunity issues
  - Existing and potential future conflicts with each party's non-JV businesses
- Scope of non-compete covenants and the confidentiality obligations of each party
- Any core technology or other intellectual property ("IP") either to be transferred to the JV or to be granted by the parties to the JV

(continued)
Scope/Purpose of the JV (2)

- Other inter-corporate arrangements that either will be required for the JV to operate or that are required to make the investment in the JV meet the business case
- Due diligence
  - Generally no less than that required for an acquisition and in many cases more thorough
Regulatory Issues

- Current and any anticipated regulatory issues, including:
  - Foreign ownership
  - Antitrust
  - Export control issues
  - Labor and employment issues

- Restrictions, registration and other issues related to ownership and control of the JV, its assets, the operation of its proposed business, and IP resulting from research

(continued)
Regulatory Issues (2)

- Dilution, exit and liquidation rights
- Government requirements for accounting treatment in JV
- Government and contractual obligations to third parties (bank and other)
- Approvals required for the implementation and ongoing operation of the JV, including non-compete or confidentiality obligations
Tax Considerations

- Flow-through, independent taxation or consolidation with parent(s)
- Income, VAT, property tax issues
- Non-profit status issues
- Taxation of IP
- “Off-shoring” potential
- Credits against the partners' home country tax liability
- Repatriation
Deal Structure

- “Pure” patent licensing with little or no collaboration
- Collaborative deals
  - Co-commercialization
    - Certain aspects of discovery research relegated to R&D entity; trials, regulatory and commercialization were left to commercial “partner”
      - Sale and marketing of a product under a single trademark, with cooperation in commercializing
      - Co-marketing (independent simultaneous sale and marketing by parties of a defined product under different trademarks)

(continued)
Deal Structure (2)

- Co-development
  - Discovery research and/or product development activities, with a continuing role by each party
- Joint ventures
  - New entity to develop and market a drug
- Equity acquisitions
  - Ultimate collaboration in terms of shared goals
Beginning the Process: Letter of Intent/Term Sheet

- Binding or non-binding
  - If binding:
    - Ensure all key provisions covered – may be difficult to introduce new business points after signing
    - Unless and until replaced by a definitive agreement agreed to by the parties within a specified time – no material changes without further approval
      - Consider use of arbitration if parties cannot agree upon definitive agreement or if there is a dispute as to interpretation of letter of intent
      - Consider whether to include covenant to negotiate in good faith definitive agreement

(continued)
Beginning the Process: Letter of Intent/Term Sheet (2)

- Appropriate approvals received before signing
  - Board and stockholder approval
  - Regulatory approval
  - Third-party contractual consents, etc.
  - If approvals not obtained in advance, letter of intent could provide that it becomes effective once the necessary conditions precedent have been met

- Non-circumvention/no deal shopping issues

- Consider whether to leave confidentiality agreement in place or replace it with confidentiality obligations in letter of intent

(continued)
If not binding:

- Can structure so that it becomes binding upon approval within a specified time and/or subject to signing a definitive agreement

- Will need to draft very carefully to ensure non-binding letter of intent or term sheet cannot subsequently be found to be binding

(continued)
If no separate confidentiality agreement, ensure that while most of letter of intent is non-binding, confidentiality and non-solicitation covenants are intended to be binding.

If not binding, what other provisions need to be binding.
Parties

- Which parties should be parties to the JV
  - Parent entities as parties or simply guarantors
    - How far up the chain is it necessary to go
      - To ensure performance of the obligations of the JV parties
      - To enforce non-competition covenants, etc.
  - Government entities as parties
  - Should JV entity be a party
    - Specific enforcement of obligations
    - Iterative consideration of structure of JV
Governance

- Depends largely upon the actual structure chosen (another iterative loop back)
- Management vehicle to direct the JV
  - Extent of the authority given to the management vehicle compared to reserving significant decisions to the joint venturers (shareholders, members or partners); fiduciary duties at different levels will factor into this decision
  - Choice of appointees to the board or management committee and accountability to the joint venturers
  - Authority to retain and remove personnel, including the chief executive officer

(continued)
Governance (2)

- Management vehicle to direct the JV (continued)
  - Scope of protection for each joint venturer on fundamental decisions and changes – particularly where one of the co-venturers has a minority ownership interest
  - Substantive standards and processes for dealing with non-arm's length transactions and other conflict-of-interest situations
  - Process for developing, approving and updating the business plan and budget
Management Committee or Board of Directors

- Board representation or formula
  - If a 50-50 Board is established, will have to deal with deadlock possibility
  - Giving chair a casting vote in 50-50 situation effectively results in unequal representation on Board

- Particular qualifications for members of management board and any particular prohibitions on who can act

- Removal and replacement of members of management board

(continued)
Management Committee or Board of Directors (2)

- When and how often will management Board meet
  - Notice requirements
  - Quorum for valid meeting
  - Can management Board members be represented by alternates (generally not permissible in a corporate JV)
  - Who can call meetings
  - Under what circumstances can management Board act without an in-person meeting – i.e., telephonic meetings or actions by signed consent

- Powers and duties of management Board
  - Matters requiring approval of parent(s)
  - Matters requiring super majority or unanimity
Officers

- President, CEO
- Managing Director or general manager
- Overall leadership versus responsibility for the day-to-day operations
- CFO/financial management

(continued)
Which co-venturers have right to nominate which officers or whether the management Board has that right
- Certain venturers could have right to nominate certain officers; right to nominate could rotate (often found with Chair)
- Right to remove and replace officers
- Limits on authority of officers, signing authority, etc.
- Directors' and Officers' Liability Insurance
Auditors, Reporting and Access to Information

- Who will the auditors be
  - Auditors of one of co-venturers or independent
  - How can firm be changed

- Frequency of financial statements
  - Nature and frequency of other reporting requirements

- Permitted access for co-venturers to books, records and employees
  - Notice, during business hours, etc.

- Should rights be removed/restricted under any circumstances
Actions Requiring Consent – Either Board or Co-venturers

- Approval of annual business plan and budget or any change to any approved annual business plan or budget
- Transactions outside the ordinary course of business [over a specified $ annual threshold]
- Change of name or scope of the business
- Creation of subsidiaries
- Admission of new co-venturers, transfer of ownership interests, issue, sale or transfer of shares or rights

(continued)
Actions Requiring Consent – Either Board or Co-venturers (2)

- Incurring debt, granting security or guarantees
- Payment or other distribution or return of capital
- Change in management Board, establishment or change in committees or appointment or removal of officers
- Insolvency-related actions
- Certain types of contracts
- Approvals required in connection with litigation or other proceedings
Disputes

- Mediation
- Litigation or arbitration
  - Mandate of arbitrators (i.e., is it any dispute between the party or only specified types of disputes or under specified clauses)
    - Certain types of disputes may not be arbitrable
    - Specific performance
    - Preserving right to go to court for certain types of breaches (e.g., breach of confidentiality, non-solicit or non-compete)
  - Set out rules or cross reference to specific set of rules (e.g., ICC)

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Consider whether there should be prohibition on arbitrator amending the JV agreement or granting punitive damages

Number and how chosen

Parameters around how arbitrators are to act (e.g., findings of fact and conclusions of law)

- Location of actions
- Applicable law
- Costs – who pays what
  - Breach of JV agreement
  - Determinations of a particular value or payment (e.g., license fees or termination costs)
Financing and Support

- Financing provided by the co-venturers
  - Pro rata to interest in JV
  - Optional or a required
    - What if one co-venturer does not have the necessary funds
  - Maximum amount either in actual dollar terms or based upon some formula
  - Who can initiate capital call and who determines what type of capital call it will be – debt or, if applicable, equity
  - Consider fixing in advance all relevant terms of debt, including repayment terms, ranking of obligation to repay, etc.

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Financing and Support (2)

- Third-party debt financing
  - Non-recourse or backed by assets or guarantees
  - If guarantees are to be given, limits and pro-rata to the percentage interest
  - Security granted

- Co-venturer support
  - To what extent each co-venturer is going to provide support or services to the JV
  - Pricing for such support and services
  - Substitution for co-venturer support if not provided
Intellectual Property

- Intellectual property transfer from parents to JV
- Allocation of rights to parties and JV rights
- Right of first refusal/preferences
- Residual and derivative rights
- Existing agreements that impact the IP and technology
- Provisions/laws (e.g., Bayh-Dole) that may "contaminate" technology or IP
- IP of the parents’ family members

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Intellectual Property (2)

- IP claims or litigation
  - Representations and warranties as to existing
  - Control of claims and litigation
  - Costs
  - Damages and recoveries
- Validity, enforceability, ownership, scope and protection
- Third-party consents
- Open source software issues
Privacy and data protection
Local legal regime
- Statutes and regulations
- Enforcement
- IP legal practice
- Restrictions on the ability to transfer that intellectual property out of the country
- Protections for intellectual property that is transferred to a venture in that country and intellectual property that the venture develops
- Risks connected with a state-owned or controlled entity?
Transfers

- Assignment or by a license
- Royalties or capital contribution/distributions
- Exclusivity
- Ongoing technology/IP obligations to/by the JV

Compensation/contribution for “foreground IP,” which is the IP created by the JV alone or in combination with its JV partners

(continued)
Terms of assignments, exclusive licenses, non-exclusive licenses, or manufacturing/supply agreements for components that embody, but do not disclose, the IP

Joint exploitation issues

March-in rights

Reporting, accounting, audit and payment terms issues

Term and termination of transfers/payments

Cost and Administration of IP registration, enforcement and defense
Separation and Termination

- How the termination will occur
- Returns of property that a party transferred to the JV, restoration of intangibles
- Employees, consultants and subcontractors
- Goodwill
- Employee benefits
- Future opportunities
- Payments to the parents and to creditors
- Buy-out formulas
- Continued cooperation by parents, noncompetition

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Separation and Termination (2)

- Remedies on termination or separation
  - Accounting
  - Payments
  - Specific performance and prohibitions (injunctions, etc.)

- Technology issues
  - Licenses
  - Grantbacks and continuing licenses
  - Rights of a withdrawing party
  - Opportunity to grant licenses to a third party
  - Compulsory licensing
Separation and Termination (3)

- Trademarks, databases and other IP
- Duplication of tangible know-how
  - Manuals
  - Work-in-progress and similar materials
  - R&D implementation (test-beds, prototypes, tooling)
References

- ABA Model Joint Venture Agreement – Checklist for Joint Venture Agreements, Thomas W. Van Dyke, ALI-ABA COURSE OF STUDY MATERIALS, Representing the Growing Business: Tax, Corporate, Securities, and Accounting Issues, November 2005

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