OPEN AIR BLOG

Case Study #3: Joint Venture or Junior Varsity

Before I start in on my now-familiar criticism of the Guidance case studies, I want to pass along something from the Dow Jones Global Compliance Symposium. A little while back, I published a post called “On Getting Advice” in which I named several outside counsel and in-house compliance officers who I liked. As I’ve told my boss numerous times since, I enjoy competence. I like reading good writers, hearing good speakers. It’s something you know right off, and it’s incredibly hard—if not impossible—to fake.

The Dow Jones GCS panels were all high-quality; it’s one of the reasons I like going to their conferences. But three people stuck out. With these three, they wore their competence on their sleeve. I had not known these people beforehand, and other than thanking two of them for their panel performance, I’ve never spoken with or worked with them.

But I would, in a New York minute.

Two were on the same panel, one about avoiding problems in Africa. A third panelist was one who I’ve already mentioned as fantastic in On Getting Advice, Billy Jacobson. He lived up to my high expectations. Two of his other panelists, Sophie Lamont and Herbert Igbanugo, blew me away. I think at one point, I might have heard of Nardello & Co, which is where Ms. Lamont is head of their Africa practice, but I don’t really know anything about them. But they have a star on their hands. First, she held her own with Billy, which is something not many can do. She spoke about the cultural differences in different parts of Africa. The other panelist has his own legal practice. Let me tell you, if I were opening an office in sub-Saharan Africa, he and Sophie would be my first calls.

The third person was Josie Jardim, General Counsel for Latin America for GE. If you’re a large business with operations in Latin America, the best possible move you can make, I guarantee it, is to back up a money truck and try to hire her away from GE. It might be tough, because GE is a great company, but for your sake, try. It’s also the first time I’ve heard a panelist say, “I have no idea how to do that; if you figure out a way, give me a call.” Refreshing. Especially so because her depth of knowledge was encyclopedic. I wish I could go back and watch her speak over again.

Okay, back to Case Study #3.

This hypothetical involves the formation of a joint venture by a medium sized company. The JV was formed between a UK company and a company local to a risky country with foreign mineral deposits. The UK company recognized in their risk assessment that this JV presents serious risks of bribery.

As usual, the guidance names optional controls, neither prescribing nor suggesting the mixture:

–Parity of representation on the board of the JV
–That the JV put into place measures designed to ensure compliance with applicable laws. These measures "might cover such issues as:" a) gifts and hospitality; b) decision-making rules agreed to by the local partner; c) procurement; d) rules for engaging third parties, along with due diligence procedures; e) conduct off relations with public officials; f) training for staff in high-risk positions; and g) record-keeping and accounting.
–Establishment of an audit committee with at least one representative from the UK company and the local partner; the committee should have the power to view accounts and certain expenditures, and should prepare regular reports.
–Binding commitments by both partners to comply with all applicable bribery laws; a breach by one is a breach by the JV, with material breaches allowing termination.

I'm frankly weary of telling you how little the case study suggestions help. But the total lack of common sense that is evidenced by these four suggestions spurs me to new efforts.

A JV is one of the riskier methods of engagement and entry into a market. You get all the worry of a proprietary operations, all the risks, but lack the complete control. A JV is you, but not you, and you get the worst elements of each. If a JV bribes someone, the UK partner faces UK liability. Even under the self-limited jurisdiction the guidance espouses, the SFO has jurisdiction here. So you have to constantly monitor the actions of the JV.

The first thing that sticks out is the lack of audit rights of the UK company. Now, I know, the six of you that regularly read this are shouting, "audit rights?! You?!" Yes, I can actually at times—very limited times—think that audit rights are a good idea. This is one. If you form a JV, having an audit committee of the JV audit itself just isn't good enough. This would be one of the few times I'd say that you should spend whatever you need to, hire Manny Alas, and have PWC audit the hell out of the JV. If the JV partner objects, tell them it's a deal-breaker.

Remember, the reason you're forming a JV in the first place is that it's a riskier market where you don't want proprietary operations. Or it's a location like China where foreign ownership rules make JVs more attractive. It's not like China poses any risks, right? Yes, I know that there are other reasons to form a JV, like a pre-existing smaller company getting better distribution, and the larger partner getting a local presence. There are lots of reasons. I maintain that JVs are riskier entities.

The other thing that stands out as totally lacking is any mention of due diligence on the partner before formation of the JV. You might say that a JV partner is just another type of third party that we'll cover in Case Study #6. You would be wrong. Because of the closeness of the relationship, I put JVs in a whole other category. You need better, more frequent diligence.

Given these two stunning omissions, I'm hesitant to say I agree with the four bullet points. It's like, "other than that, Mrs. Lincoln, how was the play?" But let's go through them anyway.

Point one: have you ever heard of a JV formed where both component companies didn't get board representation? Me either. Parity is something else. I take parity to mean that you and I get an equal number of seats. I've never seen that, either. It's based, in my experience, on percentage of ownership. I own 75%, I get 3 out of the 4 board seats. I've seen a lot of China JVs that were 51%/49% because of the foreign ownership rules. But the China company got a majority of seats, albeit only by 1. Here's what I would suggest: you must have a representative on the board, but I would ask for management control, or at least veto power over management personnel decisions. You want your people in key positions. CFO. Head of HR. Some senior sales position. Marketing. Whatever is relevant in that market. In China, for instance, I would make sure the head of HR is mine. And even then, I'd rotate my people out of that position every 18 months. I'd do the same with the CFO. And I'd make sure that each of those positions had a mandatory 2-week vacation, where I'd bring someone else in for those two weeks to see what was what.

And why would the guidance list "measures designed to ensure compliance" rather than just say that the JV should have all the same controls as a UK company. It would take up less space, anyway. As it is, ensuring policies and procedures exist for gifts, hospitality, procurement, and diligence are all good ideas. I would place a greater emphasis on training than the bullet points seem to. Just one mention, and even then only for "staff in high risk positions." I'll forgive them for not hyphenating the phrasal adjective (it should be "high-risk positions") but not for the oversight of the need to train everyone. I think that "conduct of relations with public officials" is redundant in an effective program, but I guess it doesn't hurt anything.

Having an audit committee within the JV is okay, I guess. But as I lay out above, I'd want audit rights for the UK partner.

Termination provisions. Let's talk about that. In most circumstances, exiting the JV means exiting the market. So we need to be very careful about termination. Plus, it will almost always open you up to litigation in the market against a local company.

The DOJ's position on terminating JVs has, in my opinion, evolved over the years. I remember hearing DOJ personnel say that if there were a suspicion of bribery, and it couldn't be resolved, the partner had to exit. I don't know that they'd say that now. I would love an opinion release request on the subject, but that'll never happen. What's the right thing? Can I be like Josie for a moment and say, "I have no idea?" The question is self-disclosure if your objections to the deal aren't heeded by the JV. Do you blow the whistle on your own JV? Do you have to back out the revenue, but be allowed to maintain the JV?

I don't know. Put your suggestions in the comments.

I think my summation for this case study's suggestions is "woefully inadequate." Definitely not a varsity effort. More worthy of the JV team. (Sorry for the pun).