The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

Legal Highlights: Friends Will Be Friends?

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December 17, 2015

The Legal Highlights section did not involve the reporting or the editorial staff of The Moscow Times.

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Goltsblat BLP is the Russian practice of Berwin Leighton Paisner, an award-winning international law firm.

Joint ventures in the economy and in law

Under the Soviet economic system formed after WWII, all means of production and capital funds were owned by the state alone, so no joint ventures other than inter-state trade and manufacturing associations were, of course, possible. Reforms launched by the Soviet government in the late 1980s allowed individuals to engage first in personal business and then also in collective forms of entrepreneurship, such as production cooperatives. These were the first joint ventures at a time when the state economy was undergoing gradual privatisation.

The "joint venture" itself is embedded in many Russian's minds as a legacy of the 1980s-90s transitional period. In legal practice, as well as everyday life, it symbolized an influx into Russia of both prominent and less known foreign companies and corporations that tapped energetically into the new developing market and helped build joint businesses under that nice new name.

At that time, the JV format was applied to all types of partnership – from a major plant or factory to a fast food booth at a railway station. In the latter case, use of the JV abbreviation was likely to give you a laugh, yet its commercial and legal substance was not diminished by this branding technique, except, maybe, cases when a "joint Russian-Italian basement" venture trading in "the latest fashions from Milan" was opened by someone definitely not Italian nor even Russian, and the trendy addition to the company name was used only to attract consumers craving things from Western Europe.

As a result, many economics dictionaries and academic works in the Soviet era and even today understand a joint venture as an association of businessmen from different countries. This somewhat narrows its economic and legal meaning, since a joint venture actually implies just any project involving the joined efforts or capital of several partners. This could be a cross-border public company investing in natural resources or, just as likely, a limited company set up by high school buddies to service and repair kettles.

Partnership as a source of conflict

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In business, partnership is nearly always a means for overcoming difficulties experienced by one or several parties to the potential JV, multiplied by a desire to nurture a project or, what is more crucial in a crisis, to preserve it. Difficulties a JV initiator experiences are not necessarily of a financial nature, even though the need for external financing is, very likely, one of the most popular reasons for setting up a JV. Yet those seeking to attract a co-investor are very often motivated by factors other than money. While one might look for expertise and technology in a partnership, another might pursue new connections and knowledge or hope to make use of assets required for qualitative development and expansion.

Sometimes, such a partnership yields strong and long-lasting synergy, allowing for a genuine breakthrough, but sometimes there is only disappointment and headaches in store for one or several of the joint venturers. This happens when initial difficulties associated with possession of limited resources are replaced by problems of mutual understanding and division of authority issues. There are enough examples of decade- and even century-long partnerships that have survived their founders, but there are also plenty where joint ventures have broken up or even been wiped out due to a conflict between the partners.

The origins of such conflicts are found in both purely business matters and relationship psychology. In the latter case, a corporate dispute often resembles a family hassle and sometimes ends in a painful divorce.

Causes of JV conflicts, matters of dispute and agreement formalization issues

Below, we bring to the fore the principal and most frequent causes, in practice, of conflicts between joint venturers.

• Different assessment by the partners of their roles in the JV and potential benefits of the joint business

• Different visions of JV development strategy

• Essential differences in corporate culture and a general culture gap

• Personal relations crisis between key managers and beneficiaries

The above reasons translate into disagreements in two key areas: management and finance. As a result, the dispute escalates from the conceptual to the legal plane and often creates an impasse that jeopardises the JV's operations by preventing corporate decision-making.

In practice, parties argue vigorously over management efficiency and about whose of the two nominated managers is the best one. They argue about business plans and criticize reports on their implementation, often depriving the JV of its primary guiding document for regulating how the CEO should conclude transactions and spend funds. They argue over the procedure for electing directors and then argue, via their representatives, on the Board of Directors itself and, finally, argue about Board resolutions and Director liability.

Even more heated disputes evolve between joint venturers, when the economy is in trouble, over funding of joint projects, including direct cash-ins by the partners and the terms and conditions of guarantees, pledges and other security often required for attracting external finance. Parties also quarrel a lot about dividend payments when one of the venturers needs quick money to save a business it owns outside the JV, while the other partner would rather re-invest the profits in the venture.

Of course, it is great if there are strict and clear-cut (as opposed to wink-and-nod) arrangements in place between the stakeholders. This is doubly true if they are competently and accurately formalized in legally binding documents. Yet practice shows that things are really far from ideal in this respect. This applies to purely domestic JVs, which often rely only on their Articles of Association to regulate the participants' obligations, and to complex, multi-tier structures where the parties traditionally and preponderantly conclude shareholder agreements under English law.

Management and financing obligations of the parties are far from always transparent or deriving directly from the effective corporate or contractual documents approved or executed when the joint venture was set up. This is often because the partners rely on the wink-and-nod arrangements they made in "good times" or the documents regulating joint business were drafted by business negotiators, rather than lawyers, when the JV was being formed.

The situation is frequently made even more complicated if a transaction party conceals its real objectives from its partner, in an attempt to disguise obligations under declarative provisions in the JV binding documents. True objectives are sometimes concealed even from the partner's own legal counsel, which, of course, does nothing to improve the functional effectiveness of the agreements. At the same time, good lawyers can almost always customize documents to dovetail with a specific transaction structure, provided they fully understand the essence of the client's assignment and the agreements reached by the partners.

Equally, problems occur when counsel, led by good intentions, includes in the provisions obligations that are as broad as possible, without providing the mechanisms required for their implementation, which, importantly for this category of case, nearly always consist in corporate procedures. Yet, for the purposes of any JV, one key priority even in the formation stages is to develop robust legal structures and instruments to preclude potential conflict or, if a conflict does occur, to specify means of settlement as clearly and in as much detail as possible.

All this entails considerable difficulties in resolving differences that already exist, by pushing up legal aid costs for both parties and hampering owners in assessing conflict resolution prospects. It is no wonder that, the more is at stake in a conflict, the fiercer the resistance put up by the procedural opponent, which becomes more difficult to persuade, even if the most reasonable and justified arguments are used.

Behavior patterns and typical errors in a corporate conflict

If differences between partners are likely to turn into a corporate conflict, the venturer should prioritize compliance with certain rules of behavior. This will provide it with, first, sufficient arguments if the dispute goes to court and, second, a reputational advantage over the opponent, which is important in policy terms. Such rules will certainly vary for different conflicts, but we consider the following to be of utmost importance:

(i) early on, forecast the conflict's potential implications for each party and the joint project

(ii) observe written agreements

(iii) act in good faith, refuse to do anything obviously harmful to the other party and, especially, the JV (this is becoming more important in view of recent civil law changes)

(iv) piece together a set of arguments consisting of direct and indirect proof of an existing agreement on the disputed matter and its implementation or breach

(v) choose the correct method for defending your rights and the appropriate jurisdiction

(vi) demonstrate amicable intentions and offer a choice of options for out-of-court resolution.

It is critical that acting "nicely" should not put you off your guard or give you reason to expect the opponent to behave likewise. Quite often, a party with a strong initial legal and commercial position loses the tactical advantage in a dispute if it relies on wink-and-nod agreements and the good faith of the partner and considerably underestimates the

opponent's capabilities and resources. As with any other conflict, it is important to balance peaceful and aggressive but legally justified actions and tools of influence.

One decisive success factor is, of course, proper legal preparation for the dispute (and this is not to advertise the authors' occupation!). A dispute is like an illness – the quicker you call in a skilled doctor, the lower the risk of complications and the higher chances of resolving the issue in the most efficient manner. Yet do not forget to provide your doctor with a detailed case history, to ensure that his assistance is truly productive. If you unearth a contract left and forgotten some time in your security box, one that changes the entire disposition in the case, this would be even worse than remembering you were allergic to some medicine after you start to take it.

In the midst of a corporate conflict, even in its earliest stages, it is important for each party to resolve correctly the dilemma as to whether the JV should be dismantled and the business be continued single-handedly, or whether attempts should be made to save the partnership, despite the current controversy. In other words, given the acuteness of the brewing dispute and associated changes in the partnership relations, each of the parties involved should ask itself: "Is there life together after the conflict?"

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