

<h1>Selected Issues Arising in Joint Venture Transactions</h1>						
--	--	--	--	--	--	--

Rodney L. Moore

David Gail

# Key Considerations in Selecting JV Structure

- Shield against liability
- Regulatory / licensing considerations
  - Licensing of JV entity
  - Antitrust / competition law issues in collaborating with JV partner
- Flexibility of ownership / voting / management structures
  - Employee and other service/support arrangements
- Fiduciary / implied duties
- Mechanics of transfer of business or assets to JV (may drive use of in-place entity)
  - Due diligence preparation: identification of assets to be contributed; excluded assets; consent requirements
  - Consider necessity of related assets/IP
- Covenant limitations in existing debt agreements (particularly HY debt indentures)
- Accounting (consolidation) issues
- US structures include corporations, general or limited partnerships, limited liability companies, contractual joint ventures (or “virtual jvs”)

## Key Considerations in Selecting JV Structure (continued)

- Tax considerations
  - Avoiding double taxation (where possible)
  - Access to losses and tax credits
  - Taxes associated with forming the joint venture and transferring business or assets to it
  - Ongoing taxes of the JV and its members
  - Taxes on allocations, distributions and dispositions or sales to one party
  - International tax aspects, including taxation in host country of the JV and/or its members, possible application of tax treaties and special rules for real property and governmental venturers

# Key JV Issues

## Economics

- Ownership
- Tax Considerations
- Capital Contributions/ Commitments/Default Remedies
- Contribution Agreement
- Budget
- Debt Financing
- Impact on Partners' Balance Sheets
- Dividend / Cash Distribution
- Accounting Treatment

## Governance

- Majority, 50/50 or minority position?
- Board Size/representation
- Board Committees
- Selection of Senior Management
- Protective Rights/Super Majority Voting Provisions (Board/Shareholder)
- Fiduciary/Implied Duties
- Dividend Policy/cash management
- Deadlocks on operating plans/other key issues
- Dispute Resolution

## Operating Agmts & Other

- Non-compete agreements
- Management Agreement
- Reporting / Information Rights
- Services and Supply Agreements
- Secondment Agreements (secondments vs. JV employees)
- Employee Matters (pension/benefits)
- IP Rights Ownership / Licensing
- Compliance and other Policies and Programs

## Exit Provisions

- Transfer restrictions
  - Lockup period
  - Permitted Transfers
- Pre-emption Rights; ROFR; ROFO
- Drag/Tag Rights
- Change of Control/Indirect Assignments
- Buy/Sell Procedure
- Put / Call Options
- Liquidity Rights
  - IPO/Registration Rights
  - Right to Force Compulsory Sale
- Termination Events
- Consequences of Termination

# Selected Joint Venture Issues

- Ownership Split
- Valuation Issues
  - Enterprise valuation
  - Asset Valuation
- Capital Commitments & Default Remedies
  - Initial requirements/commitments
  - Subsequent commitments/Preemptive Rights
  - Availability of external, independent financing arrangements
    - Obligation to utilize available debt capacity/seek debt financing
  - Default remedies
    - Dilution (punitive vs. fair market value vs. agreed upon valuation/methodology)
    - Other remedies

## Selected Joint Venture Issues (continued)

- Contribution Agreement Considerations
  - Valuation issues
    - Effective time and related adjustments
  - Applicability of HSR
  - Environmental matters
  - Sufficiency of assets
  - Insurance arrangements
  - Other representations and warranties
  - Allocation of Liabilities
  - Indemnities
  - Dispute resolution

## Selected Joint Venture Issues (continued)

- JV Agreement
  - Broad or limited purpose clause
  - Governance
    - Board composition
    - Officers – independent/dedicated vs. sponsor provided with potentially competing obligations
    - Minority Protection/Supermajority voting provisions
    - Fiduciary Duties/Standard for decision-making
    - Frequency of meetings

## Selected Joint Venture Issues (continued)

- JV Agreement continued
  - Budgets
    - Approval rights
    - Budget deadlocks
    - Default budget
  - Non-compete and corporate opportunities
    - Scope & duration
    - Business opportunities
    - Disclaimer of PE business opportunities

## Selected Joint Venture Issues (continued)

- JV Agreement continued
  - Resolution of conflict matters
    - Non-conflicted party will control
  - Restrictions on Transfer/Exit rights
    - Lockup period
    - Permitted transfers
    - ROFO/ROFR rights on transfers by other party
    - Drag-along rights/Tag-along rights
    - Treatment of COC events; indirect transfers
    - Liquidity rights

## Selected Joint Venture Issues (continued)

- JV Agreement continued
  - Distribution of “available cash”
    - Standard for determining amount of excess cash flow to be distributed
    - Potential for deadlock
    - Tax distributions
  - Bankruptcy provisions
  - Dispute resolution procedures
  - Deadlock Termination/Exit Provisions

## Selected Joint Venture Issues (continued)

- Other Commercial Agreements
  - Credit agreement for JV entity
  - Employee secondment or employee transfer agreement
  - Services or transition agreement
  - IP-related agreements (trademarks, name use, etc.)
  - Indemnity bond agreement (covering surety or construction bond obligations)
  - Guaranty to back capital contribution commitment

# Selected Labor and Benefit Issues

## ■ Labor Matters

### ■ Employee liabilities

- If employees are shared, who makes decisions regarding employment status
- Controlling party generally should have liability for exercising rights and provide corresponding indemnity to other party

### ■ Workers' compensation considerations

- If JV owns assets but does not employ individuals operating assets, it may not be entitled to workers' compensation bar to liability
- Some states permit joint employment arrangements for purposes of workers' compensation bar; requires detailed agreement (often in the form of a secondment agreement)

## Selected Labor and Benefit Issues (continued)

- Labor Matters *continued*
  - Union relationships
  - Costs of employees
    - How are costs to be shared – per hour cost, percentage of monthly load, volumetric formula, other
  - Confidentiality and non-competition
    - How should employees be restricted from sharing confidential information of sponsor/employer and JV
    - What happens to existing non-competition agreements if employees are transferred or shared? Can they be assigned? Question of state law.

## Selected IP Issues

- What IP will be contributed by each partner to the JV
  - Assignment
  - License (exclusive/nonexclusive; Field of use; term; control)
- Ownership of “Foreground IP” (IP created by the JV either alone or in combination with the JV partners)
- Ownership of IP on termination
- Access to “Background IP” (IP licensed by a partner to the JV) on termination continue
- Partners rights to JV’s IP outside of JV’s scope of business

# Selected Upstream JV Issues

- Structure Considerations
  - Seismic/other restricted use data
  - Ownership of leasehold interests
  - Specified depths/formations covered/MUI's
  - Scope of lands covered (drilling units vs. leasehold coverage)
- Development Considerations
  - Drilling/right to operate
  - Drilling program/budgets (number, timing, etc.)
  - Non-consent rights
  - Water sources/issues

## Selected Upstream JV Issues (continued)

### ■ Financial Considerations

- Hedging
- Debt financing
- Up front cash payment
- Promote (scope of covered costs)

### ■ Midstream Considerations

- Scope of venture
- Committed production
- Capacity
- Gathering/marketing arrangements

### ■ Other Considerations

- Title/Environmental
- Hydraulic Fracturing
- AMI
- Transfer restrictions/preferential purchase rights

# Selected Midstream JV Issues

- Tax Structuring
  - Tax impact based on amounts contributed and cash paid/liabilities assumed by JV
  - MLP and “qualifying income” analysis
- E&P Reserves to support system/committed production
  - Formations covered
  - Current production v. obligation to commit future production
  - Land v. contract
  - Obligation to develop upstream assets
- Capacity
  - Ability to support E&P growth
  - Processing
  - Take-away capacity

## Selected Midstream JV Issues (continued)

- Business Opportunities
  - Expansions/Extensions/Laterals
  - AML/adjacent or “proximate” locations
  - Renewal/termination of existing contracts
  - Rights with respect to other partner- owned midstream assets
- Commercial Considerations
  - Gathering agreements
  - Processing agreements
  - Marketing agreements
  - Well connection obligations
  - Other service agreements