

Joint Venture Risks

Kevin Roe (408) 374-7035

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Joint Ventures

- Essentially a partnership between companies for a limited and specific business goal
- Can be very attractive - in many ways
- Can be a joint venture of a US company with another US company, or a foreign company

Risks

- Joint venture company (JVC) steals your intellectual property (IP – e.g., trade secrets, patented inventions, and/or anything of any competitive business value) – very common
- JVC's employee(s) steal your IP for their own benefit – to start their own company
- JVC intentionally or accidentally reveals your IP or business plans to other parties
- JVC takes your key employees

Other Risks

- JVC might be initially good, but the relationship could later explode over some real or imagined incident, creating a fiasco
- JVC might do something on their own that brings very bad publicity to your company
- JVC might involve you in criminal case
- JVC might intentionally or accidentally sabotage your chances with another JVC

Joint Venture Scenarios

- They propose to manufacture products using your IP
- They propose to market products incorporating your IP
- They propose to do joint product development or research with you
- They propose some other type of mutually beneficial partnership

Warning Flags

- They say that they want to learn by working with you.
- They say that you should team up with them because they have connections with a government or a potential client company.
- They say they want to team up with you to get more “respect” locally – in your territory or their territory.

More Flags for Risk

- Prospective business partner repeatedly proposes starting a project or venture with you, with first draft proposal very lop-sided in their favor – this predicts the future
- Prospective business partner wants to be recipient of the client's payments – to be shared with you after payment

Relationships Are Fragile

- When everything goes perfectly, a JVC relationship can work
- When even a small glitch in communications, in actions, or in understandings occurs, then a JVC relationship can disintegrate within hours
- Then their resources work against you

Practical Precautions

- Investigate the JVC, their past relationships with other “partners” or anyone who used to work for the JVC
- Beware of potential JVCs that are 2nd or 3rd tier companies in their market – these are the companies most desperate to gain a competitive advantage in any way that they can

Talk to Previous Victims

- There must be hundreds, if not thousands, of US companies (especially California high-tech startups) that have had their IP stolen by JVCs
- Some JVCs, especially foreign JVCs, have done the same trick to several companies in succession
- Find out the track record of the potential JVC – BEFORE you even start a deal

Get the Money Up-Front

- If potential JVC refuses to pay any money (e.g., anywhere from \$100,000 to \$10,000,000) up-front as an initial payment for any IP they are acquiring – this fact alone tells you they will NEVER pay you
- This could also indicate that the JVC employee is acting entirely on their own

JVC Damage Control

- Find ONE tough-minded person in your company to be the SOLE conduit for ALL communications between the JVC and your company – needs to be very shrewd and mentally tough
- Do not under any circumstances allow direct access by the JVC to your R&D people – they will blab everything to the JVC – e.g., Lockheed and Los Alamos

Basic Truth About Contracts

- No contract can realistically protect you against a dishonest person or company
They will find a way to cheat you
- Before entering any contract, research the other party. Do Internet searches using their name and terms such as “lawsuit” or “defendant” or equivalents

Ambiguity in Contracts

- One common problem - ambiguity, which can cause big trouble
- Define all the contract terms explicitly to avoid ambiguity that will lead to misunderstandings, then to bad feelings, then to disputes, and ultimately to litigation

Preliminary Precautions

- Avoid time deadlines or high-pressure situations that force you to sign a contract that you don't fully understand
- If you are being manipulated into signing quickly, usually a trap is hidden in the contract

Find Help to Read the Contract

- Find one or two people (100% on your side) to read the contract before you sign it
- Other readers often detect issues that you completely overlooked
- Note - even Harvard MBAs have signed absolutely disastrous contracts – e.g., Enron

Beware of Canned Contracts

- Beware of a contract completely written by the other party. Frequently absurdly lopsided in their favor
- Beware if someone says that a contract is their standard form contract, and that it cannot be changed for any reason
- ALL contract forms CAN easily be modified, if the other party is motivated

Beware of Sham Contracts

- A special subset of canned contracts is the sham contract
- Beware of sham contracts that have the impressive legal wording of a contract, but which do not obligate the other party to do anything significant for you
- Such contracts exist

Procedure Before Signing

- (1) Obtain at least one copy of the contract on paper that is expendable – that you can cut it up and mark it up so that you can fully understand what it means
- (2) Determine the actual scope of the word definitions – they sometimes have definitions far different from common usage

Beware – Material Adverse Change

- Beware of a contract provision that requires you or either party to immediately produce a pile of cash (collateral) if your business has a material adverse change that scares the other party about your performance
- Example – Enron's problems allowed other contracted parties to invoke the material adverse change clause, bankrupting Enron

Beware – Penalties

- Some contracts can impose large cash penalties if the performance of one party is too late or defective
- Assume the worse might happen and estimate what the penalties could be. Are they far beyond your cash flow?

Beware – Litigation Location

- Beware of contracts that require any litigation to take place in a location far away from your home state
- Disadvantages - not finding a good attorney, not understanding local court rules, paying for room and board during trial, and losing your business and customers from your distractions

Beware – Litigation Costs

- Beware of contracts requiring losing party in any contract legal dispute to pay all litigation costs, especially if you have far less financial resources than the other party
- Example – large companies can easily bankrupt or force surrender of a smaller business during the litigation

Beware – Termination Cost

- Beware of contract provisions that require you to pay huge termination payments to the party that does not want to terminate the contract
- Small example – VTA had a contract with a supervisor requiring VTA to pay out > \$450,000 to terminate him

Beware Indemnification Clauses

- Many contracts require you to repay all the other parties losses or damages (i.e., indemnification) for tax penalties, injuries, IP infringement, and so forth
- Risk of these future costs to you can far exceed the contract's benefit to you
- Either delete these clauses, or cap your liability to no more your contract benefit

Hidden Dangers – Omissions

- Some contracts are very dangerous not because of the clauses, but instead for the exposure created by a clause that is absent
- Missing contract clauses that are essential are more difficult to identify than risky clauses in the contract

Beware – No Alternative Dispute Resolution

- Beware of contracts lacking alternative dispute resolution as a far cheaper alternative to litigation, especially if you have far less cash than the other party
- Example – small company contracting with much larger and richer company, depending only on litigation for disputes

Beware – No Integration Clause

- This clause will state that the contract expresses the complete understanding of the parties and supersedes all prior representations, agreements, and understandings, whether written or verbal

Why Is Integration Important?

- Integration clauses prevent the use of prior negotiations to contradict or add new terms to the contract
- If either party thinks new contract terms can be added in their favor, this increases the risk of disputes and litigation

Beware – No Assignment Clause

- This clause will specify whether or not one of the parties can assign its rights to another entity. This clause could also specify whether or not one of the parties can delegate its duties to another entity
- Why? Many companies go bankrupt and assign their contracts to raise cash – might be bought by the worst company

Escaping Bad Contracts

- If you materially breach a contract, you risk a lawsuit for various money damages
- You could ask for modification of the contract
- You could look for something that will make the contract void (invalid), voidable (by you), or unenforceable

Avoiding Litigation

- Litigation is likely when there is considerable contract ambiguity
- Litigation usually occurs when both parties believe that they have a good chance to win
- When one party is clearly in violation of a contract, litigation is far less likely

General Legal Issues – Illegal Intelligence

- Downloading and stealing information (does not have to be a trade secret) incurs criminal and civil liability under the Computer Fraud and Abuse Act
- Stealing trade secrets incurs criminal and civil liability under the Uniform Trade Secrets Act (in California) and federal Economic Espionage Act (if enforced)

Court Requirements

Before trial can be held, court needs –

- Subject-matter jurisdiction to decide case (e.g., a federal court needs a federal question, or diversity of citizenship and > \$75,000 at issue)
- Personal jurisdiction over the parties
- Court for the trial also needs to be proper venue (proper location for litigation)

Relevant Laws

- Foreign Corrupt Practices Act – U.S. companies and U.S. controlled companies cannot bribe foreign government officials
- Computer Fraud and Abuse Act – prohibits unauthorized access to a computer to obtain information or cause damage

Summary

- Thoroughly check potential JVCs upfront
- Talk to previous partners of potential JVC
- Implement damage control if you proceed – by contract, in communications, on everything
- If joint venture action's legality is questionable, ask yourself how it would look to neutrals. If it would look bad - it is probably illegal