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PROFITABLE PARTNERSHIPS

How to avoid disputes in overseas retail joint ventures

Addleshaw Goddard's International Arbitration team in Dubai has recently resolved a long-running dispute between a distributor and its joint venture partner, a well-known luxury brand. The experience provides a cautionary tale for retail joint ventures in foreign jurisdictions. Here Paul Hughes, from our Dubai office, offers his top tips for successful joint ventures.

Across the Middle East and North Africa, and many other foreign jurisdictions, it's often mandatory to take on a local partner or sponsor in order to trade within that territory. Retailers and leading brands new to a region often form joint ventures (JV) with a local partner in order to benefit from the partner's local know-how and on-ground experience.

With so much invested in a JV relationship, it's crucial to ensure everything is handled correctly. The following steps might help you avoid protracted and costly disputes.

Complying with local laws

- **Underlying documentation**

No matter the governing law of the shareholders' or JV agreement, ensure that its provisions do not conflict with mandatory local laws. Ultimate enforcement of the agreement will most likely take place in the domicile jurisdiction of the JV company, so shareholders' agreements should be drafted with any local provisions in mind.

- **Maintain compliance throughout the relationship**

Pay attention to local laws relating to running a JV company, and seek local advice if you wish to manage the company's books and accounts in a location anywhere other than the JV's domicile jurisdiction.

- **Director duties**

Directors appointed by the brand to the JV's board must act in accordance with their duties under local law. While your appointed directors are free to adapt your brand's overarching strategy and take advantage of resources and know-how, any actions taken should be in the best interest of the JV company.

For example, courts in the GCC view the payment of dividends an essential part of any company, and care should be taken when deciding to reinvest profits rather than distribute them as dividends to local shareholders.

Transparency is key: Deciding to not declare a dividend should not be made simply by way of board resolution (without proper discussion), particularly if your brand's appointed directors can push decisions through by majority (which is often the case).

Running the JV

► **Purchases**

Caution should be exercised when establishing the buying policy. The directors implementing the purchasing policy must act in the best interests of the company, and any over-purchasing, for example, is likely to have a negative impact on the JV's gross margins.

Bear in mind, too, that any over-purchasing could be said to be benefitting the brand (and not the JV) if stock purchases are agreed at wholesale prices but subsequently sold back to the same parent company at a lower net book value. This may lead to suggestions that directors appointed to the JV by your brand are acting in the brand's interests rather than the JV's.

► **Marketing**

Ensure that marketing expenditure relates solely to products over which the JV has exclusive distribution. If, for example, your brand's product is distributed by a separate entity, the JV should avoid incurring costs in advertising those products.

► **Visas**

It's often convenient for staff to work across your brand's various stores in a particular region, but it should be clear to the relevant ministry of labour which company employs an employee, and where his or her employment is based.

If an employee is to work out of the premises of the JV but is not employed by the JV, consider implementing a services agreement between the two companies to formalise the individual's duties and salary.

The process should be transparent and always in the best interests of the local JV company.

► **Alternative agreements**

If your brand wishes to avoid potential arguments with your partner over control of the company, consider an agreement whereby the local partner takes a percentage of net sales, as opposed to a share of profits.

The local partner receives a share from the JV, and is in a position to offer its services and assistance locally, but there is no confusion about how the JV is to be run. This avoids the local partner being concerned with the bottom line or distribution of dividends.

Termination mechanisms

► **Call options**

Be wary of what termination mechanisms are enforceable in the local territory of the JV entity. Shareholders' agreements will often contain call and put options. If issuing a call notice, the mechanism should be followed to the letter. Even then, specific performance (i.e. an order compelling a shareholder to sell its shares) is notoriously difficult to obtain in many GCC jurisdictions, so the ability to compel a reluctant partner to transfer shares cannot be guaranteed.

► **Valuing your partner's shares**

You are contractually obliged to follow the valuation mechanisms set out in any agreement. Even if the valuation is not disputed by the opposing party, a court or arbitral tribunal may find against you if you have not applied the appropriate steps required in agreement.

Conclusion

Given the potential pitfalls of entering into and exiting foreign JVs, all efforts should be made to maintain cordial relations with your JV partner. Many of the disputes we see arise because of a perceived loss of face, or a lack of mutual respect.

By taking care to preserve an amicable commercial relationship you can avoid lengthy and costly disputes where, ultimately, it will be difficult to compel your partner to physically transfer its shares to you.

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