EXECUTIVE SUMMARY. The important points raised in this article include:

- Forming a **joint venture** in the United States can be a favorable method for a foreign company to quickly penetrate the North American market, although the foreign company has **less control** over the joint venture entity than it would have over a **wholly-owned subsidiary**.
- Because many joint ventures are terminated within ten years of their creation, a foreign company considering a joint venture must plan for **how the operation** of the joint venture and the **end of the joint venture** will **affect** its other business interests.
- For a joint venture involving a foreign company to succeed in the U.S., it is necessary for the joint-venture partners to **trust** each other, share a strategic **vision** and develop a **compatible business culture**.
- Joint-venture agreements usually contain "**non-competition**" clauses that **restrict** the joint venture partners’ right to manufacture or sell certain of their own products during the life of the joint venture, and the "non-competition" restrictions will often apply for a period even after the joint venture agreement is terminated.
- Because the purpose of many joint ventures is to develop **new products** or **technology**, the joint-venture agreement must be written carefully to **protect** the Intellectual Property rights that the **foreign company** will be sharing in the joint venture, and **specify** the rights of each joint venture partner in **Intellectual Property** that is **developed** through the joint-venture entity.

**Advantages of a Joint Venture.** Joint ventures are attractive in a challenging economy, as companies look for ways to expand their “footprint” and increase their profits while limiting their capital investments and risk. A foreign corporation that once considered forming a wholly-owned U.S. subsidiary to create or penetrate a market in the U.S. for a new or existing product may now be looking for a joint-venture partner instead.

There are several advantages for a foreign corporation that forms a joint venture (or “JV”) with an American “partner” instead of establishing a wholly-owned U.S. subsidiary. By joining up with an established U.S. company in a joint venture, the foreign company can more quickly establish or gain access to the U.S. market. More importantly, the foreign company does not have to bear all the costs and risks of manufacturing and
distributing the products by itself. This is especially true where the foreign company is looking to introduce new technology to improve a product that is already distributed in the U.S. by several companies. In the right circumstances, finding an American joint venture “partner” might be a better avenue for a foreign company than establishing a wholly-owned U.S. subsidiary.

In such a scenario, the foreign company may contribute its new technology to the JV, and in exchange, it is paid a license fee by the joint venture entity based on the goods manufactured and sold by the JV entity. The American partner might contribute its distribution network, market experience and domestic management in return for a commission on the goods manufactured and sold by the JV entity. Both companies contribute capital, and to the extent the joint venture entity earns a profit, the JV partners may elect to pay themselves dividends on their respective shares in the JV entity. (If the JV is a partnership or LLC, the profits/losses will flow through to the joint venturers.) The relative contributions of capital, manpower, and facilities will vary, depending on where the joint-venture products are manufactured and whether the existing facilities and labor force of either joint-venture partner are used to manufacture or assemble the JV products. If the foreign technology is unique or advanced, the parties may elect to establish a new “greenfield” facility.

While the rewards may be substantial, a foreign company that plans to form a joint venture in the United States with a local partner faces unique risks and problems. Part I of this Article focused on the risks that a foreign company faces if it does not properly identify and protect its existing confidential information and intellectual property (“IP”) prior to disclosing such information to its potential joint-venture partner. In this Article, we discuss some of the risks and restrictions a foreign company may encounter in forming a joint venture, even a successful one – risks and restrictions that can only be avoided if the foreign company addresses them before the joint venture is formed. As discussed below, these risks and restrictions include:

- The need to structure an appropriate “non-competition” clause in the Joint Venture Agreement for the JV partners that will not overly restrict the foreign company’s right to sell its own products outside the joint-venture territory while the JV is in effect, and that will not overly restrict the foreign company’s right to sell its own products after the joint-venture has been dissolved.

- The foreign partner’s need to reduce the risks that will naturally accompany the sharing of its highly valuable IP and know-how with a competitor or potential competitor located outside its native country, and the need to specify in the Joint-Venture Agreement who will own the new IP developed by the joint-venture, and to what extent each partner will be allowed to use the new IP in its own business operations both during the life of the JV and after the JV has been terminated.

These legal issues, and other joint venture risks, are discussed below.

**Challenges of Entering into a Joint Venture.** The challenges a foreign company faces in undertaking a JV in the United States are clear when you understand that many joint ventures as terminated within five to ten years of their creation. Sometimes, joint ventures “end” because they meet the goals of the JV partners, and the JV entity is dissolved. More often than not, though, the joint venture fails earlier than expected because the JV partners: (a) have different corporate cultures; (b) have developed differing goals; (c) simply cannot work together in the spirit necessary to achieve the hoped-for success or; (d) market/financial conditions make the JV no longer feasible or desirable to the parties, and/or; (e) one or both of the JV partners are unwilling to make additional capital contributions. Foreign companies that have never participated in a joint venture with an
American partner, but have managed a wholly-owned U.S. subsidiary might not appreciate – at first – how different the participation in a joint venture can be from managing a wholly-owned subsidiary.

Another major difference between entering into a joint venture and operating a wholly-owned U.S. subsidiary is that the foreign parent has exclusive control of its subsidiary and can determine the subsidiary’s goals and the resources that will be contributed to the subsidiary to help it achieve those goals. Those goals may be longer term and may defer short-term profits in favor of longer-term results. But in a joint venture, the partners, in theory, have equal involvement in the management of the JV entity, and the desires of one JV partner will not always be accepted by the other partner. Generally, the partner that has a physical presence where the JV entity operates will end up having greater influence over the operation of the joint venture entity than the “absent” foreign partner. This creates an additional challenge for the foreign JV partner to overcome. In addition, the joint venture partners may have fiduciary obligations to each other.

Joint ventures involving a foreign partner sometimes fail because the JV partners do not share the same business culture. The day-to-day managers of the JV entity may not appreciate or respect (perhaps unintentionally) the decisions of the foreign partner. This includes not just the senior management of the American partner who help shape the goals of the joint venture, but also includes plant supervisors and sales managers engaged by the joint-venture entity. In many instances, the people holding these positions are already associated with the American partner; they are people whose loyalty probably will lie with the American partner in the event a serious disagreement arises between the joint-venture partners. It is not uncommon for the front-line JV personnel in the U.S. to see the foreign partners’ involvement in JV matters as “interference” or “meddling.” This is especially true if no serious effort has been made to explain to the JV employees that the JV partners are equal and that the contributions of both partners are necessary for the joint venture to succeed.

With those challenges in mind, a foreign company looking to participate in a joint venture in the U.S. must understand before the joint venture is established, that it will be providing valuable IP to an actual or potential competitor, and that even if the JV is successful, there is still the possibility that your joint-venture partner might soon be your global competitor. And they may be using your IP or IP that you helped develop to compete with you. Therefore, it is essential for the foreign company to think about what will happen when the JV ends even before the joint venture is formed. This is especially true for a foreign corporation that will be contributing its IP to the joint venture for the purpose of developing and selling a new product into the U.S. market.

As discussed at greater length in Part I of this article, the rights and obligations of a joint venture formed in the U.S. are primarily controlled by the Joint-Venture Agreement (the “JVA”). In addition, the joint venture will likely involve a separate Confidentiality Agreement, a Supply Agreement, an Intellectual Property Agreement and related documents. Of course, the JVA and the related agreements are subject to controlling U.S. law. Consequently, the creation of a joint venture in the U.S. might involve federal and state anti-trust laws if the joint venture involves companies that compete in the U.S. Therefore, even from its initial conception, the creation of a JV is a more complicated legal undertaking than forming a U.S. subsidiary. In addition, the JVA and the related agreements must be carefully tailored to identify the goals, obligations, and rights of the JV entity to be formed, as well as specify the separate rights and obligations of the JV partners during the term of the JV and after it is terminated.

Foreign companies, especially, should look suspiciously at JVA documents that are represented as “the standard JV agreement.” The preparation of a Joint-Venture Agreement is not a “standard” legal project, and the preparation of the JVA cannot be left to the lawyers alone -- the management of the foreign company must have meaningful involvement of the creation of the JVA. If the foreign partner is not deeply involved in the crafting of the JVA, or if the foreign partner leaves the drafting of the JVA to its American partner, the
agreement might eventually have serious adverse consequences to the foreign JV partner; consequences that go beyond the life and territory of the joint venture.

**JV Restrictions on Sales of “Non-JV” Products.** One of the first issues that a foreign company must consider before entering into a joint venture is how the joint venture will limit its rights to sell its own products in other markets while the JV is in effect. A Joint-Venture Agreement commonly contains undertakings by both partners that neither will sell any products independent of the JV that will compete with the products sold by the JV (a “non-competition” clause”) in certain territories, markets or to certain customers during the life of the joint-venture. The “non-competition” clause often restricts both companies’ rights to sell non-joint-venture products outside the joint venture-territory, both during the life of the joint venture and after the JV ends. Foreign companies often do not fully consider the full impact of the “non-competition” restrictions contained in the JVA until after the joint venture products have been developed or the joint-venture entity has begun operations. And, of course, sometimes the products developed under the JV are not what the partners planned when they first began their product development.

When the JV partners begin to develop products for sale through the joint-venture entity, they might not know that one or both partners will want to sell those same products (or products based on the JV products) outside of the joint venture distribution network during the JV term. For example, if a foreign manufacturer, using its standard product design, develops a special product to be sold exclusively in the United States through the joint venture, it sometimes does not think that there might be a market for this same product either in its own country or in other parts of the globe. Thus, two-or-three years after a joint venture is formed, the foreign manufacturer realizes that restrictions contained in the Joint-Venture Agreement might prevent it from selling the same or similar products in a market that is not covered by the joint venture. The American JV partner might protest the sale of such products, and will point to the JVA “non-competition” restrictions as a basis for a demand that no such sales be made. At this point, it might be too late to look to the contract for help in addressing the foreign partner’s desires.

Therefore, great care must be taken when drafting the “non-competition” provisions of the JVA to anticipate how the development of the JV products might affect each partner’s other business operations. The “non-competition” provisions must be narrowly tailored to (a) meet the purpose and goals of the JV; (b) address the expectations of the JV parties and, of course, (c) assure compliance with all applicable laws, especially, U.S. anti-trust laws.

**Protecting the Foreign Partner’s IP Rights and IP Developed in the Joint Venture.** Similar to the drafting issues that have to be considered in the “non-competition” area are the issues that must be addressed with respect to protecting the foreign partner’s rights in the IP that it will be sharing in the joint venture. Protecting your own IP should be the first obligation of the foreign company’s legal team. This is especially true if there is any possibility that the confidential information to be contributed to the joint venture would not be afforded legal protection by an American court. But even if the IP the foreign partner will be contributing is determined to be entitled to the protection of U.S. law, then the JVA must clearly specify that the foreign company retains all ownership rights in its own IP. Quite frequently, the JVA provides that the joint-venture entity will only license the use of the foreign company’s IP or other know-how during the life of the joint venture. The JVA should also specify that all IP created though the joint venture that is derived from the foreign partner’s IP will be the exclusive property of the foreign partner. Again, the joint-venture entity should only be given a license to use such derivative IP during the life of the joint venture. The drafting of the provisions that relate to the
ownership and use of IP need to be written with the meaningful involvement of the foreign partner’s management and with an expansive view of how the joint venture might evolve over time.

**Conclusion.** Because joint venture agreements are intended to meet different goals, it is nearly impossible to provide general advice regarding what should be contained in a specific joint-venture agreement. But, as a starting point, a foreign company that will be contributing/licensing its proprietary or confidential product information to a joint venture in the United States should first consult with a U.S. attorney to determine how to best protect its intellectual property rights. This step must be taken *prior* to disclosing this information to the potential joint-venture partner. The foreign company contemplating a joint venture in the United States should also consider the potential risks and restrictions that will be imposed upon it by the joint venture—limitations that might restrict sales of the foreign company’s products outside of the joint-venture territory during the life of the joint venture and even after the joint venture has been terminated.

It is equally important that a foreign joint-venture party regularly assess whether its JV goals are being met or are likely to change in the near future. If the foreign corporation determines that changing circumstances mean that its goals for the joint venture will not be met, it should consult with its attorneys to determine the legal impact terminating and/or restructuring the joint venture will have.

(Reprints of this articles, as well as Part I of Preparing for a Joint Venture, are available in both English and Japanese, by contacting the authors.)
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