

Laboratory Joint Ventures

Key Business and Legal Issues

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Anthony D. Konkoly
McDonald Hopkins LLC
Cleveland, Ohio

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McDonald Hopkins LLC
Attorneys at Law

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I. Introduction to Joint Ventures

A. What is a Joint Venture?

1. Association of two or more parties to collaborate in an enterprise to achieve specified business objectives.
2. Generally characterized by sharing of profits and risk.
3. May be structured through commercial contracts (contractual joint venture) or through establishment of new entity jointly owned by the participants (equity joint venture).

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B. Why Create a Joint Venture?

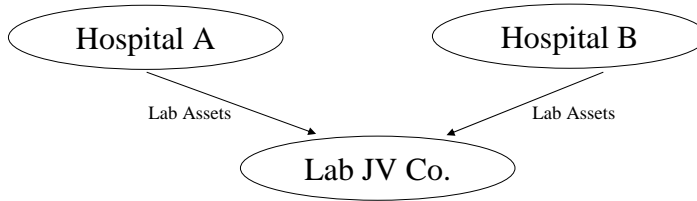
1. Create competitive advantage not otherwise available to any participant individually.
2. Share complimentary resources and capabilities to drive success of an enterprise.
3. Seek to reduce risk, increase likelihood of success, reduce capital requirements.
4. Possible source of capital through partial sale of existing lab business.

C. Examples of Resources/Capabilities
(that each participant may contribute)

1. Capital
2. Existing business (revenues, profits)
3. Brand name/reputation/goodwill
4. Market Access/Position
4. Facilities/Assets
5. Information technology
6. Management Capabilities
7. Economic of scale/cost savings
8. Esoteric testing/proprietary testing capabilities

D. Examples of Lab Industry Joint ventures

1. Outreach Joint Venture



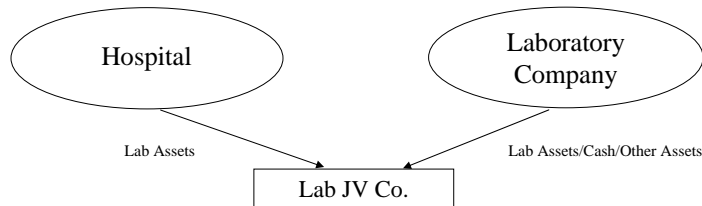
Goals:

1. Provide lab services to hospitals
2. Build outreach business
3. Cost savings/Efficiencies

Structure:

1. Each partner contributes existing hospital lab operation and cash
2. Build larger lab
3. Hire new management team

2. Hospital/Lab Company JV



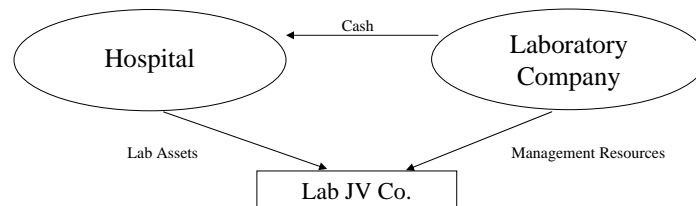
Goals:

1. Build stronger regional outreach business
2. Cost savings (hospital lab and outreach)
3. Take advantage of brand/reputation

Structure:

1. Each partner contributes lab operation or cash
2. JV to service hospital lab needs and outreach

3. Hospital Forms JV to Raise Capital



Goals:

1. Hospital sells interest in outreach lab, raise capital for other purposes, but keeps substantial equity stake.
2. Cost savings
3. Better management

II. Selecting a Joint Venture Partner

A. Capabilities

1. Reputation
2. Financial strength
3. Strength of existing business
4. Management capabilities
5. Technical capabilities
 - Information technology
 - Esoteric testing/proprietary testing
6. What will the Partner contribute to the Joint Venture?

B. Commitment

1. How important is the Joint Venture to prospective partner?
2. How easy will it be for partner to exit?

C. Compatibility

1. Organizational compatibility/common business philosophy
2. Conflicting allegiances or interests

III. Structuring the Joint Venture/Core Issues

A. Scope

1. Services to be provided
 - Generally includes both clinical lab and anatomic pathology
 - Specialty testing? Reference work?
 - Outreach only, or also include hospital lab?
2. Geographic Scope
3. Exclusivity
 - Are partners obligated to buy services from Joint Venture?
 - Is Joint Venture obligated to use a partner for reference work?

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B. What will each participant contribute?

1. Cash or assets
2. Technology
3. Management
4. Other

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C. Economic Interests

1. Valuation of Each Partner's Contributions
 - Need for independent appraisals
2. Ownership Interests for Each Partner
3. Allocations of Profits and Distributions
4. Compensation for Goods and Services Supplied to Joint Venture

D. Governance and Control

1. Board of Directors
2. Officers/Executives/General Managers
3. Veto Rights/Supermajority Voting
4. Audit Rights/Access to Information/Selection of Auditors
5. Day-to-Day Management vs. Major Decisions

E. Choice of Entity

1. Corporation or Limited Liability (LLC)
2. Pass Through Start-Up Losses and Profits

F. Tax Issues

1. Tax-Exempt Issues
 - Control of Joint Venture or “Insubstantial part of overall activities”
 - Use of Facility with Tax-Exempt Bond Financing
 - “Consistent with Charitable Purposes”
 - Fair Market Value for services provided by or to Joint Venture
2. General Corporate Tax Structuring Issues

G. Financing the Joint Venture

1. Start-Up Capital
2. Working Capital
3. Expansion Capital
4. Initial Capital Contributions
5. Additional Capital Contributions (need dilution mechanism)
6. Set Time Schedule or Milestones for Contributions
7. Credit Facilities (partner guarantees?)
8. Partner Loans to Joint Venture (security interest?)
9. Intent of Partners Regarding Distributions

H. What Documents/Agreements Will Be Required

1. Joint Venture Agreement (?)
2. Organizational Documents
 - Articles of Incorporation (or equivalent)
 - Bylaws (or equivalent)
3. Shareholders' Agreement/LLC Agreement

4. Ancillary Agreements

- Support Services Agreements
- Lab Services Agreement
- Leases

5. Contracts with Third Parties

- Loan or Credit Facility
- Contracts with Customers
- Supplier Contracts
- Pathology Group Contract

IV. Legal Issues

A. Basic Contract Negotiation Issues

1. Noncompetition
 - Scope
 - Duration
2. Assumption of Liabilities by Joint Venture
3. Representations and Warranties (re Existing Business)
4. Indemnity Provisions

B. Dispute Resolution

1. Breaches of obligations
2. "Escalation" Approach
 - Refer to Senior Management
 - Then, Binding Arbitration
3. Management Deadlock
 - No good way to resolve
 - Buy out provisions?
 - Liquidation?

C. Exit Strategies/Termination

1. Restrictions on Transfer
2. Right of First Refusal
3. Put or Call Rights
4. Triggers (e.g. Change in Control of a Partner)
5. Determination of Price
6. Termination Rights (Liquidation)

D. Antitrust Issues

1. Formation of "Monopoly"
2. Hart-Scott-Rodino (HSR) Filings (larger deals)
3. Issues during planning/negotiation phase
(for current competitors)
 - No Price Fixing
 - Forbidden Topics (prices, allocation of markets, customers)
 - Document Exchange

E. Other Documentation

1. Confidentiality Agreement
2. Letter of Intent
 - Be Specific
 - Address Material Issues
 - Scope
 - Exclusivity?
 - Conditions
 - Non-Binding

V. Other Considerations

- A. Commitment of Top Management of Each Partner
 - Otherwise, JV will be an afterthought
- B. Mutual Benefit must be Guiding Principle.
- C. Communication/Trust Building is critical.

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D. Due Diligence

1. Investigate partner's business (like M&A deal)
2. Do thorough Business Plan with Cash Flow Projections

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VI. Conclusion

- Be patient!
- Be flexible! (expect conditions and business needs to change over time – for both parties)
- Beware of inappropriate incentives or conflicts of interest.
- Documentation is important, but compatibility is critical.
- Do a thorough Business Plan