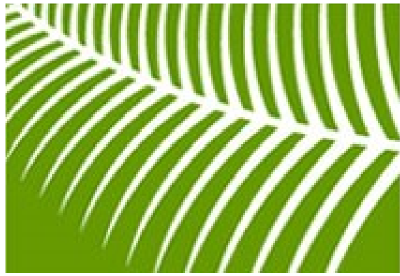

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POTENTIAL BUSINESS FORMS FOR AGRICULTURAL JOINT VENTURES

Subtheme: Financing the Farm Business

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Abstract:

Joint venture agreements continue to grow in popularity as farmers look for ways to gain efficiencies, integrate horizontally or vertically within their sector, or take advantage of opportunities they otherwise could not access on their own. While joint ventures can create a number of advantages, they should be carefully planned in advance and entered into under the framework of a formal agreement. Those agreements can take the form of contractual arrangements, partnerships, or a number of limited liability entity forms. This article presents some of the considerations farmers and agribusinesses should evaluate in selecting a joint venture form, and provides an outline of the factors joint venture members should address in their agreement, including the joint venture's scope, formation, membership, management, "buy-sell" triggers and mechanisms, policies and procedures, and termination issues.

Keywords: *Joint venture, partnership, limited liability company, corporation, taxation*

1. Introduction

Farmers face an increasingly competitive global marketplace. In such an environment, farmers face unprecedented challenges and opportunities, but many farming operations are unable to address them on their own. Conversely, collaboration with other farmers or services providers could create significant advantages for both. Consider the following possibilities:

1. Combining net profit in order to purchase services that can be efficiently shared, such as producers sharing space on a delivery truck rather than handling deliveries individually) (Prizio n.d.)
2. Sharing services internally which none of the venturers could afford on their own such as accounting, procurement, human resources, and management functions (De Jong 2017);

3. Combining capital for the purchase of equipment to create value added products such as wheat producers making flour and pastas, corn producers making ethanol, and fruit growers producing juices and jams (Kenkel & Park, 2007);
4) Sharing expertise in a manner that will benefit both venturers, such as a pig farmer contracting with a butcher to make and sell bacon under the farmer's own brand (Prisio n.d.).

In each instance, a joint venture could create a mutually-advantageous arrangement. A joint venture is "a commercial collaboration in which two or more unrelated parties pool, exchange, or integrate some of their resources with a view to mutual gain, while at the same time remaining independent" (American Bar Association n.d.). While joint ventures can provide great advantages for their members, they are also independent ventures with their own unique challenges. Given the substantial investment of resources many farms will make in joint ventures and the potential "entanglement" of their operations, they should be carefully planned in advance and entered under a formal written agreement. These agreements can take the form of contracts, partnerships, or a number of limited liability entity forms. This article presents considerations farmers and agribusinesses should evaluate in selecting a joint venture form and provides an outline of the factors joint venture members should address in their agreement, including the joint venture's scope, formation, membership, management, "buy-sell" triggers and mechanisms, policies and procedures, and termination issues.

1.1. The scope of the joint venture

As the Bard said, "This above all – to thine own self be true…" (Hamlet, 1.3.564). And yet, a study of 2,200 American, Australian, and Canadian farmers found less than 30% of those farms had a written business plan in place (Wittman 2004). Thus, perhaps the first step (or even "step zero") in the planning process for any joint venture should be for the parties contemplating the venture to develop a well-crafted business plan for themselves and to carefully evaluate whether the proposed venture indeed meshes well with those plans. A number of resources are available to aid in this (Hofstrand 2016).

Once the potential joint venturers have plans in hand, they should then proceed to a dialogue regarding the scope of the joint venture. Before any of the considerations below are addressed, the fundamental business of the joint venture should be clearly established.

The discussion of what the joint venture will *not* do holds equal importance, however. Especially when two or more similarly-situated farms consider a venture, the potential exists the operations could be competitors, albeit amicable ones, and care must be taken to avoid potential issues arising from this circumstance.

1.2. Liability for the joint venture

Any agricultural venture carries a number of potential liabilities. Whenever debt financing is involved, recourse for unpaid obligations against the venture (and potentially its partners) looms. However, a number of joint ventures carry liabilities of significantly greater magnitudes. Food sales, particularly as those transactions are closer to the ultimate consumer, can carry liability for injury or death caused by contamination or other hazards. Transportation and manufacturing / processing ventures carry similar liabilities for accidents. Judgments in such matters can reach into the millions of dollars, threatening not only the assets contributed to the venture, but the assets of the venture's members as well. This specter looms particularly large in agriculture, as the assets at stake may be multigenerational farms with strong emotional connections for their owners.

Thus, the structure of the joint venture and its liability traits carry much weight. In the eyes of many jurisdictions, joint ventures are regarded as a "partnership" and particularly in countries influenced by the English common law torts doctrines, partnerships convey "joint and several liability." In simplest terms, if the partnership incurs a liability, the party seeking recovery against the partnership must first pursue the assets of the partnership. If those assets are insufficient, the assets of the individual partners are now at risk. Further, if one partner has either insufficient assets or those assets cannot be found, the other partner may bear the entire liability, with only a right of recovery against the other partner. This is an important hazard of the partnership form (which, as mentioned above, may be an unintended consequence of the joint venture agreement).

Conversely, corporations are a well-understood limited liability entity form in many jurisdictions and provide the highest level of protection against liability by forming a "wall" or "veil" between the entity and its owners. The concept of the limited liability company (LLC) in the U.S., and its counterparts in other jurisdictions (such as the limited liability partnership or LLP in the U.K., the GmbH in Germany, etc.) has grown in acceptance and in most jurisdictions offers exactly the same liability protection as a corporation while also providing much more flexibility in its organization and operation. While the formation of a limited-liability entity may involve some additional up-front

costs and add a moderate amount of complexity to the operation of the joint venture, the potential liability protections will often tilt the cost /benefit analysis sharply towards a corporation or LLC.

1.3. Choosing a form for the joint venture

Given these issues, the form of the joint venture poses significant importance. At a bare minimum, a written contract should form the basis of the joint venture, addressing the points discussed throughout this article, but particularly stating the joint venture agreement is not intended to be a partnership (unless a partnership arrangement is actually intended by the members) and addressing the liability and indemnification issues.

Moving one step up the entity continuum, there is the formal partnership. Partnerships pose considerable liability challenges, but in some circumstances joint venture partners still prefer them due to tax considerations. If a partnership is indeed intended, a formal partnership agreement should be created. The members might also consider placing their partnership interests within a limited liability entity to provide some liability protection.

Proceeding further up the continuum, one finds the LLC. As mentioned earlier, the LLC can provide the liability limitations of a corporation, but can be crafted to function and (in some jurisdictions, such as the U.S.) to be taxed as a partnership *or* as a corporation. In fact, an LLC can be designed to exhibit traits of both a partnership and corporation and has tremendous flexibility with respect to the dimensions discussed in section 2 of this article.

Finally, there is the corporation. Corporations have been recognized for centuries as limited liability entities. Its tenure provides significant certainty with regard to how corporations are handled in terms of liability, governance, taxation, and operation. However, that history also carries the burden of several constraints on it as an entity form.

It should also be noted the cooperative form should like somewhere on this continuum. Historically, many cooperatives have been organized as corporations (although many have also been organized as partnerships), although increasingly a number of new cooperatives – and particularly "next generation cooperatives" (NGCs) are organizing as LLCs. Many jurisdictions have created entity forms specifically for cooperatives carrying some form of limited liability.

Selection of a business entity should involve the counsel of an attorney, accountant, tax advisor, and potentially business consultants or advisors. Selection of the

right entity for the type of activities undertaken by the joint venture can be a significant advantage, just as selection of an inappropriate form can pose significant obstacles.

2. Considerations for joint venture agreements

After defining the scope of the joint venture and selecting an appropriate entity form – "big picture" items – the joint venture members must turn their attention to the numerous details of the venture. While the devil may lie in such details, one should also note the value in the discussion of these details. A thorough discussion of the following points not only leads to a better joint venture agreement; it also helps the venture members think through a number of issues confronting the joint venture that might not otherwise be addressed. The discussion itself might hold as much if not more value than its product in terms of its facilitation of strategic thought with respect to the venture.

It should be noted the following discussion assumes a business entity such as an LLC or corporation is formed for the joint venture. However, even if a contractual arrangement or partnership is used, many of the same considerations hold.

2.1. Formation of the joint venture

Forming any venture requires some foundation of assets and people. One of the first questions is what kind of asset base will be required, and how will the members provide that base? If assets are contributed directly by the members, what type of membership interest (stock, membership units, etc.) will be provided in return? Do the members desire to keep contributions equal, or are unequal contributions and ownership allowed? When physical assets are contributed to the entity, is title to the property itself contributed or is use alone granted? Depending on the answer, potential tax consequences arise if the joint venture is terminated and / or if the property is returned to the contributor.

2.2. Membership in the joint venture

In its most basic form, a joint venture involves two parties working collaboratively. With equal participation by both members, there may be only one "class" of membership. With multiple parties and different forms of participation, though, there may be a need for different classes of membership, each with rights and obligations tailored to the class. What are the rights and obligations of each class? Is it possible a venture member could change classes?

Who may be admitted as a new member to the joint venture? By what majority of existing members should a new member be admitted?

One important responsibility of any membership unit or class of membership is responding to “capital calls” occurring when the venture requires an infusion of resources. Joint venture agreements should specify whether the joint venture has the power to make capital calls, and if so, under what circumstances and by what majority of votes. The consequences for failing to answer such a call should also be determined, whether they are the triggering of a period in which the non-answering member may “cure” their failure to contribute, the “dilution” of the non-answering member by reallocating membership units to the other members, or the expulsion of the member.

Does membership come with a certain length of commitment that must be honored or a penalty for early withdrawal is imposed? For example, a cooperative looking to make long-term investments in equipment with a significant payoff period for debt and payback period for the investment may require a membership duration commensurate with the time horizon of that investment (De Jong 2017).

Are their circumstances in which voluntary withdrawal from the joint venture is allowed without penalty? In such events, are mechanisms in place for the repurchase of the exiting member’s interest? Are their circumstances in which a member will be deemed to have forfeited their interest due to a breach of the joint venture agreement?

2.3. Management of the joint venture

The mechanisms by which the joint venture will handle both its tactical and strategic management functions can take a number of forms. In the case of a corporation, day-to-day operations are usually handled by officers of the corporation. The bylaws of the corporation often specify certain activities of significance (such as contracts, purchases, or incurring indebtedness, all over some specified value) must be taken only after a vote of the shareholders.

With LLCs, however, there are two options of importance. An LLC can elect to be “manager managed” or “member managed.” “Manager” is the term used for someone authorized to act on behalf of the entity if an LLC, meaning the manager can sign contracts, make payments, etc. and the entity is bound to the obligation created by the manager’s action, so long as the manager’s action was within the scope of the manager’s authority in the operating agreement. Alternatively, LLCs can be “member managed” wherein all members are also managers. Member-managed entities generally work well only when there very few owners; the larger the number of members, the more complications having multiple mangers can cause.

Whether a corporation or LLC form is chosen, the scope of decisions that can be made by those in charge of day-to-day operations without a vote of the members should be defined. Also, if there is any circumstance giving rise to a "deadlock" in which the officers or members reach an impasse, a tie-breaker mechanism of some sort should be established.

At least as much attention should be paid to how the venture's "board of directors" will function. Who can serve as a member of the board, and how will representation be handled among the joint venture members? What decisions are the exclusive province of the board, and what majorities will be required for extraordinary actions (such as sale or purchase of large assets, termination of the joint venture, expulsion of a member, etc.)? How will deadlocks be broken?

In addition to a governing board, it may also be advisable to establish an advisory member to serve as a "sounding board" and source of counsel as the governing board considers its decisions. While it has no voting power, the advisory board can be a versatile and powerful tool (Wittman 2004).

2.4. "Buy-sell" triggers and mechanisms

Events may arise in the life of the joint venture or its members triggering an "involuntary" transfer of ownership. As a result of such transfers, the joint venture may find itself with a new "member" who is a stranger to the business, whether it is a creditor, heir, or ex-spouse. As a result, joint ventures should consider whether such involuntary transfer events should trigger a "buy-sell" provision in the joint venture agreement requiring the sale of the membership units or shares held by the person subject to the involuntary transfer to the joint venture or its members, and correspondingly requiring the joint venture or its members to purchase those units or shares.

When the members of the joint venture are individuals, some potential buy-sell triggering events include the death of a member (which could mean the transfer of ownership to an heir who may not be suited to participation in the joint venture), divorce of a member (which could allow the distribution of joint venture ownership to the ex-spouse who again might not be suited to participation), permanent or long-term disability of a member (rendering the member unable to properly manage their ownership interest or resulting in the appointment of a guardian for the member), and bankruptcy or insolvency of a member (which could result in the transfer of joint venture ownership to a creditor). In the case of an entity who is a member of the joint venture, the bankruptcy or insolvency of that member carries many of the same considerations; events of the

removal, withdrawal, acquisition, or termination of the owner-entity are other potential buy-sell triggers.

In any buy-sell triggering event, the agreement should define how the ownership interest should be valued, both in terms of how that value is defined (such as "book value," "market value," etc.) and how that value should be ascertained. It should also define who has the obligation to purchase the ownership interest – is the purchase an obligation of the joint venture itself or its members, or both in a defined order of priority? If a purchase is required, have assets been identified to pay for the purchase, or if insufficient liquid assets are available, how should the purchase be funded?

2.5. Policies and procedures for the joint venture

Sound business policies, consistently and equitably enforced, often distinguish high-performing businesses from their peers as they enable them to anticipate and avoid problems before they drain productivity or seriously disrupt the business – an approach called "policy before the need" (Wittman 2004).

The policies needed by the joint venture are naturally a function of the kinds of activities it conducts. At a minimum, though, almost all joint ventures would benefit from accounting policies specifying the type of accounting system to be employed (cash or accrual basis), how, and when accounting information is to be reported, and transactional policies (handling of revenues into the business and payments made out of it), policies for the steps to be taken in determining whether a dividend or other distribution should be made from retained earnings and the amount and timing of such distributions.

The most important asset of a joint venture is likely the people composing it, so employment policies are of utmost importance. As mentioned above, the members of a joint venture may have to make contributions to get the venture underway, and such contributions may include their own employees. Are there policies in place for whether employees of the members are allowed to work for the joint venture, and whether employees of the joint venture may be hired away from it by the members? Another critical piece may be family employment policies for the joint venture. Concerns over nepotism may need to be addressed, but it may also be desirable to hire family members intimately familiar with the operations of the venture or its members. If this is the case, are there considerations to be made or additional requirements to satisfy to allow family members to participate? Are there requirements of certain competencies or lengths of experience for family members to work in the joint venture?

Finally, as mentioned above, the potential exists the operations could be competitors, albeit amicable ones, and care must be taken to avoid potential issues of conflicts of interest and "corporate opportunity." In short, some jurisdictions require if a business opportunity arises within the scope of an enterprise (such as a joint venture), that opportunity must be presented to the enterprise first; if an enterprise member does not present the opportunity but instead takes it for him or herself, a cause of legal action is created in the other members. Since joint venture members are often in the same field (figuratively if not also literally), they should consider whether their agreement will waive the application of this doctrine or modify it in some way.

2.6. Termination issues

In some cases, joint ventures terminate of their own accord, having accomplished their purpose; in others, they are forced to conclude by external factors. In either case, though, the members should consider how to wrap up the business of the venture. Are there certain events that are deemed to trigger the termination of the joint venture? By what majority of member votes should termination be allowed? How will the assets of the joint venture be distributed upon the dissolution? Will one or more joint venture members be allowed to carry on the business of the joint venture upon a termination?

3. Conclusions and paths forward for farm joint ventures

Joint ventures can take myriad forms, but regardless of form, there are basic considerations that should be discussed among the venture's members and formalized into a written, legally binding agreement among the members before the venture begins. Significant time, thought, and discussion should be invested in defining the scope of the joint venture, choosing an entity form for the venture, and defining the mechanics of its formation, membership, management, potential involuntary transfers, policies, procedures, and termination or winding up of the venture. Under the adage "good fences make good neighbors," a well-crafted joint venture agreement can solve many problems before they start. Further, the discussion resulting in the formation of the agreement has tremendous value in itself by prompting the prospective joint venture members to consider a number of contingencies and their potential responses. With thoughtful planning, joint ventures can be a valuable tool to help farmers overcome challenges and take advantage of opportunities otherwise be out of reach.

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