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Mechanisms for Resolving Deadlocks in Real Estate Joint Ventures

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Many real estate deals come together through joint ventures into which different parties contribute capital, acquisition opportunities and management skills. One of the parties (typically the developer or sponsor of the deal) will usually assume the role of managing the day-to-day activities of the joint venture, while another may take the lead on obtaining debt financing. However, in almost all joint ventures there is a set of “major decisions” that require the approval of all (or at least a majority) of the joint venture participants. The list of major decisions will vary depending on the type of project, the relative experience and capital contributions of the parties involved, and other factors. The following is a small sample of some of the areas that are often subject to “major decision” approval rights: (i) the sale of the project, (ii) zoning or subdivision applications, (iii) financings and refinancings, (iv) litigation, and (v) budgets.

Investors and developers are usually able to resolve disagreements over major decisions through dialogue and deal-making, but occasionally conflicting risk tolerances or differences of opinion about the state of the real estate market can lead to intractable impasses. For this reason, parties sometimes agree to include deadlock resolution mechanisms in their joint venture documentation. Below are summaries of the most common mechanisms for resolving deadlocks.

Buy/Sell Provisions

One way to resolve a deadlock is to have one party buy-out the interests of the other party. This can be done through what is known as a “shotgun” buy-sell provision where one party proposes a value for the project and the other party chooses whether it will be a buyer or seller of its interests based on the proposed valuation. “Shotgun” buy-sell provisions do not fit all circumstances, particularly where a party may not be in a position to sell its interests due to tax considerations or may not be in a position to buy the other party’s interests due to liquidity issues. In such circumstances alternative mechanisms such as “option” or “put” rights can be devised to fit the parties’ needs. It is also important to note that buy-sell provisions may be restricted by the terms of financing documents, which require the parties to seek pre-approval from their lender.

Independent Manager/Board Member

In joint ventures with an odd number of participants, impasses can sometimes be avoided through a majority voting system. However, for those decisions that require unanimous approval, the parties can choose to appoint an independent manager or board member with the power to resolve deadlocks when they arise. This could be someone that the parties know and respect (and who wouldn’t be afraid to make a decision that would upset one of the parties), or the joint venture could engage the services of a professional, independent board member. There would likely be fees associated with bringing on an independent board member, and the parties would need to assure themselves of the independent board member’s expertise and wisdom. The parties may also need to address liability concerns that the independent board member might raise, either through D&O insurance or appropriate waivers and indemnities.

Mediation/Arbitration

Similar to having an independent board member, the parties could agree on a mediation/arbitration process for resolving deadlocks. Mediations are non-binding dispute resolution proceedings in which a third-party neutral helps the parties’ facilitate a resolution. Arbitrations, on the other hand, are binding proceedings where the third-party neutral imposes a resolution on the parties. Different variations and combinations of these proceedings can be agreed upon at the beginning of a deal to provide the parties with a more tailored mechanism for resolving a deadlock.

In connection with each joint venture, the parties should analyze the various business and legal considerations so as to ensure that the strategy they choose to address potential deadlocks is well tailored to fit their needs and the particulars of the deal.

Otten Johnson attorneys in both the Real Estate and Business Transactions & Tax practice groups have substantial experience structuring joint ventures and negotiating joint venture agreements. For more information on this Otten Johnson Alert or for help evaluating your current situation, contact any of the attorneys in the Real Estate or Business Transactions & Tax practice groups. For a listing, [click here](#).

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