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# INTERNATIONAL NEGOTIATION COMPETITION

## SPACE RACE FOR JUDGES ONLY

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# GENERAL BACKGROUND INFORMATION

## The parties

Space Research and Exploration plc ("**Space Rex**") is an aerospace manufacturer based in Blue Peaks. Space Rex has been operational for over two decades and was hailed at the time of its inception as the solution to the high costs of space exploration. It has developed and marketed several innovative products which have revolutionised the sector. For the last four years, Space Rex's main project has been the development of a reusable launch system named FANGS, which would allow:

- launch vehicles to be re-used;
- flights in outer space to be operated at a lower cost; and

- the ability to carry higher payloads for manned missions (relying on cutting-edge machinery and materials).

Market rumours are that, once operational, FANGS will be worth £1 billion.

Rickety Martin plc ("**Rickety Martin**") is a defence manufacturer and contractor based in Kway. A leading player in the international defence sector, Rickety Martin has a strong reputation with clients around the world. It is a listed company, ranked among the top 100 companies in the world (based on market capitalisation) and has large cash reserves.

## Background

After years of research Space Rex has made considerable progress with FANGS and the company now regularly tests prototypes of launch vehicles, returning impressive results. However, the high costs of research and development (R&D) and unexpected production challenges means Space Rex requires financial assistance from a large strategic investor in order to commercially deploy FANGS. Space Rex is looking to enter into a 50/50 joint venture ("**JV**") arrangement which would involve a cash injection as well as R&D support from its JV partner in exchange for Space Rex's contribution of the FANGS technology.

Space Rex, however, is very concerned about safeguarding its intellectual property. The aerospace industry is extremely competitive and any leak of confidential information could prove fatal to Space Rex's long-term success. Space Rex enjoys a strong brand image and is renowned for being a responsible company. Its motto 'Be Good' is well-known and the company leadership is keen to ensure that its reputation is not adversely affected by an investor.

The board of directors of Rickety Martin (the "**Board**") is keen to collaborate with Space Rex as part of its diversification strategy. The Board has identified the aerospace sector as a natural choice for the expansion of the business due to the transferability of materials, skills and expertise from defence. Rather than developing its own independent aerospace business the Board wants to collaborate with a more seasoned player in the sector in

order to enable faster growth and views building a relationship with Space Rex as a strong tactical option. Space Rex's FANGS project is particularly attractive to the Board as it believes this unique system has potential applications in the defence sector as well as the aerospace sector.

A number of Rickety Martin's key competitors are also looking to acquire or collaborate with aerospace manufacturers. The Board is keen to secure a quick deal in order to remain ahead of the curve.

The parties met at the Farnborough Airshow in July this year to briefly discuss a strategic partnership. Since then, representatives from both companies have identified several potential synergies between the two companies in terms of their long-term vision. After a series of meetings and initial due diligence by Rickety Martin, the parties have decided to enter into a non-binding Memorandum of Understanding (the "**MoU**") and are meeting to negotiate the key terms of the JV.

It is expected that each party will appoint an equal number of directors to the board of the joint venture company (the "**JVC**") and as such the parties are keen to ensure that decision making processes are carefully considered including what may happen in the event of a deadlock between the parties. Division of board positions, including chairman, chief executive office and chief financial officer, have not yet been discussed between the parties.

## GENERAL BACKGROUND INFORMATION (CONTINUED)

Space Rex has indicated to Rickety Martin that they would like to address any future financing of the joint venture in the MoU. They are keen to ensure that any financing in the life of the JVC does not dilute each investor's shareholdings and that any financing needs of the JVC beyond the capital supplied by shareholders should be sourced from third party financing providers.

Two days before the meeting, news broke that some Rickety Martin weapons have been found in a rebel camp in Munraya, a war-torn country which is the subject of an international arms embargo. There has so far been no evidence that Rickety Martin has exported any products to Munraya; however, Space Rex are nervous about the impact of the story on the transaction.

# SPACE RESEARCH AND EXPLORATION PLC

## Confidential information

Space Rex is looking for an investor to inject £150m into the FANGS project this year and a further £250-£300 million over a period of five years to meet the on-going development and marketing costs ("Initial Capital"). While there has been interest in Space Rex's products and expertise (including from Rickety Martin's competitors), it is mindful that an investment of this scale would usually be difficult to find without approaching a consortium of investors. Space Rex has worked with consortiums previously and has found that the decision making process can be unnecessarily time consuming; as such, Space Rex is keen to find a single investor to work with on this occasion.

Space Rex would like to retain day-to-day control of the company. While mindful that it may have to concede some decision-making power, the Board is particularly concerned about retaining authority in relation to the potential customers for FANGS. Space Rex is also concerned about its brand image and would like to exercise as much control as possible in relation to the use of Space Rex's and FANGS' names. The Board would also like to explore what might happen when there is a deadlock in decision making. It would prefer a fulsome dispute resolution procedure rather than being forced into buy-out battle with its JV partner – its resources are tied up in R&D so it would not be able to bid for Rickety Martin's stake for at least three years.

FANGS is no longer in the early stages of development but is still not ready to be deployed commercially. Space Rex is concerned that this may have an impact on the amount of funding it can raise from the strategic investor and the level of control it may have to cede. It is currently estimated that the final development of FANGS will take place over four additional phases and will take about five years to finish.

Space Rex is keen to ensure that any financing in the life of the JVC does not dilute its shareholding. Space Rex's lack of cash resources means that it would be unable to match any additional capital injections by Rickety Martin which extend beyond the Initial Capital for at least three years; as such, they would prefer for any additional financing needs of the JVC to be sourced as debt from third party financing providers.

Space Rex is keen to prevent the strategic investor from taking control of, or otherwise exploiting, its confidential information. While Space Rex is aware that it will be working jointly with engineers from Rickety Martin on developing FANGS, it is essential for Space Rex that the parties devise a working relationship whereby the confidentiality of its intellectual property is protected.

Space Rex has approached several space agencies in order to pitch FANGS as a product and platform for the future and many have expressed interest. However, considering the challenges faced by Space Rex in the past relating to costs and production timelines, no agencies are prepared to place advance orders for the platform at this point in time; although they have indicated that they may reconsider if Space Rex can demonstrate that more resources can be committed to completing and delivering the project.

The development of FANGS will involve several stages and requires raw materials and basic components sourced from third-party suppliers. Space Rex would like to be able to have the flexibility to engage with all potential suppliers in this niche field in order to get the best deal in terms of price and quality.

Space Rex is very concerned about the rumours of Rickety Martin's activities in Munraya. Although there has so far been no evidence that Rickety Martin has breached the arms embargo, Space Rex would prefer to wait until the story has blown over before announcing any collaboration between the parties.

# RICKETY MARTIN PLC

## Confidential information

The Board of Rickety Martin considers Space Rex to be an interesting venture. However, owing to a decline in the defence business, Rickety Martin's revenue figures have fallen by 12% in the past year. As a result, irrespective of the quality of the project, it would like to keep its initial investment to below £120 million although it is happy to put in similar cash injections each year until the product is launched ("**Initial Capital**").

Rickety Martin is due to release its year-end results in six weeks' time and is keen to announce the transaction at the same time to offset the poor results.

Considering the size of the investment, Rickety Martin wants to ensure that it acquires as much control over the development of FANGS as possible. The Board feels that Space Rex has made some miscalculations in the past regarding project management and have failed to exploit opportunities in the market so it wishes to have oversight of the day-to-day operations of the JV. However, the Board recognises that Space Rex's expertise and reputation in the aerospace sector will be vital to the success of the FANGS project so would be happy for them to remain as the operational 'face' of the JV. In the event of a deadlock in decision making between the parties during the course of the investment, Rickety Martin would like to be able to buy out Space Rex's interest in the JV.

Rickety Martin's preliminary diligence has confirmed that FANGS is likely to be a valuable asset, once launched. However, its diligence team has not identified any firm commitments to purchase the product. It is therefore keen to ensure that there is a ready market for FANGS and would like assurance from Space Rex that there are interested buyers in the pipeline.

The Board noted at a recent meeting that any collaboration with an existing aerospace player should, as a priority, allow Rickety Martin to improve its internal aerospace know-how and its employees to develop sector specific expertise.

Blasts Inc ("**Blast**") is a key client of Rickety Martin's defence products. It has approached the company with queries relating to the application of aerospace technology to traditional weapons systems. Rickety Martin is considering the prospect of pitching platforms or products like FANGS to Blast, but would not want to do so without reassurance that FANGS will be ready for commercial sale within the next four years.

In order to ensure that the timeframe is met, Rickety Martin would like the option to inject further cash into the JVC beyond the Initial Capital if required. They would usually expect to provide such funds by way of subscription for additional equity or by way of convertible debt.

Rickety Martin opened a dedicated Materials and Design division in April last year which is involved in the manufacture of raw materials for the defence sector. The division has proved immensely profitable and has generated a lot of interest in the industry, particularly in relation to its pioneering development of new light-weight and versatile materials. The Board believes these materials can also transform production in the aerospace sector and would be open to entering into a supply agreement with the JV, but this would of necessity be an exclusive arrangement.

Rickety Martin is aware of the recent news reports about Munraya; however, the company has very robust internal controls in place and is certain that no exports to Munraya have occurred. It is in discussions with the relevant authorities on this point, but does not expect any action to be taken.



# SUGGESTED NEGOTIATION POINTS

## Available to judges only

### Points for Space Rex

- 1 In order to deploy FANGS commercially Space Rex requires significant funds and expertise. It is looking to collaborate with an established organisation with resources which Space Rex can use to its advantage and to raise between £400-£450 million for the entire process leading up to commercial deployment, spread over the next five years.
- 2 Space Rex would like to retain control over the day-to-day operations and certain other aspects of FANGS' development. In particular, it would like to ensure that FANGS is used for purposes which would be seen as being in line with Space Rex's wholesome brand image. It is also keen to ensure that any deadlock provisions do not result in a buy-out battle for at least three years.
- 3 Space Rex would like any future financing needs of the JVC beyond the Initial Capital to be provided by third party financing providers and should seek anti-dilution protections from Rickety Martin.
- 4 Commercial deployment of FANGS will require the use of materials and components that Space Rex does not manufacture (as yet). Space Rex should seek to retain the ability to procure these from a number of manufacturers to ensure that it gets the best deal in the market.
- 5 Considering the path-breaking nature of its technology, Space Rex is keen on strong IP confidentiality protections and should seek a watertight confidentiality agreement with Rickety Martin.
- 6 FANGS has attracted interest from a number of space agencies that are excited about its potential. However, Space Rex believes a partnership with one of the world's largest companies such as Rickety Martin is necessary if FANGS is to become a reality and a commercial success.
- 7 Space Rex would prefer to wait until the story about Rickety Martin's activities in Munraya has blown over before announcing any collaboration between the parties.

### Points for Rickety Martin

- 1 Rickety Martin wants to diversify into the aerospace sector but would prefer to collaborate with an existing industry player, so that it can assess the market and build expertise. It has identified Space Rex as a potential partner considering the potential of the FANGS project. Owing to its recent results, it is not keen to invest more than £120 million immediately, although regular cash injections could be agreed over the next 5 years.
- 2 Rickety Martin wants to announce the deal in conjunction with its year-end results in six weeks' time.
- 3 Rickety Martin would like to have as much control as possible over the development of the project, or at least have joint control of the project. It would be happy however, to cede control on some issues such as hiring or internal processes. In particular, it should look to have some flexibility which would allow it to approach its traditional defence industry customers and pitch possible applications of FANGS. In the event of a deadlock in decision-making between the parties, Rickety Martin would like to be able to buy out Space Rex's interest in the JVC.
- 4 Rickety Martin is keen to ensure its new Materials and Design division is involved with the exclusive supply of materials and components to Space Rex.
- 5 Rickety Martin may develop its own aerospace know-how. Therefore, it is keen on working towards the transfer (as far as possible) of technology and/or expertise to its engineers.
- 6 Rickety Martin does not want to invest money into developing FANGS unless it gets some assurance from Space Rex that it has lined up customers who are interested in the product.

## SUGGESTED NEGOTIATION POINTS (CONTINUED)

### Potential solutions (non-exhaustive)

- 1 Space Rex should agree to transfer all the necessary know-how and personnel required to the JV, but should ensure sufficient safeguards are in place to protect this information.
- 2 The amount of investment by Rickety Martin depends on the negotiations of the parties (within the respective ranges indicated in the confidential information of both parties).
- 3 While it is vital for Space Rex to protect its brand image, it may have to find middle ground in order to receive financing from Rickety Martin. The parties may strike a balance by agreeing to a moratorium (for a reasonable period of time) on discussions with third parties relating to possible applications for FANGS in industries which may adversely affect the brand, or by giving Space Rex reasonable veto powers.
- 4 The parties should discuss what happens in the event of a deadlock. A buy-out process may be agreed, but there should be a lock-in period of 3 years. Mediation or arbitration may be elected as a dispute resolution forum prior to initiating a buy-out process.
- 5 The parties should discuss the future financing needs of the JVC. They may agree that financing should be provided by way of third party debt in the first instance; however, Rickety Martin may also seek to agree that if emergency funding is required by the JVC it can be provided by way of equity subscription which Space Rex would then have a certain period of time to match to avoid anti-dilution.
- 6 Rickety Martin should highlight the size of its investment and operational experience while negotiating for control over certain functions or roles in the JV. In addition, it should point to the fact that joint control will enable it to ensure that the project runs according to timelines and attracts the next tranches of investment from other parties.
- 7 Space Rex may opt for an exclusive arrangement for the supply of materials by Rickety Martin if the latter is able to put in place guarantees that would ensure that Space Rex receives the best deal in the market (e.g. price matching).
- 8 Space Rex should negotiate hard in relation to protection of its intellectual property. For instance, it can demand that Rickety Martin identify an exclusive team of engineers who will work only for the JV. Further, they can opt for strict confidentiality agreements, and internal safeguards such as 'Chinese walls'. Rickety Martin should seek transfer of technology/expertise down the line so may aim to dilute these protections over time, and may argue that these restrictions should not apply to applications in the defence sector.
- 9 The parties should discuss timescales for the development of FANGS. Rickety Martin should object to the five year estimate, pointing out that Space Rex have already spent four years developing the product and questioning the efficiency of their projections. Space Rex may resist giving any reassurance that the product will be ready within four years but should be open to revising their estimates and may use this to strengthen their bargaining position on price.
- 10 The parties may discuss board roles and should seek to allocate positions in the MoU.
- 11 In order to secure the six week timeframe for the deal, Rickety Martin may need to give certain assurances about its activities in Munraya in the form of warranties or indemnities.