

# International Joint Ventures – key considerations

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Who, What, When, Where & How?

## “BIG PICTURE”

- Joint ventures (JVs) come in all shapes & sizes & with many different commercial objectives, we need an understanding of the ‘big picture’:
- what’s going into the JV?
- what are the client’s primary commercial objectives?
- is it confined to a particular territory or technological field?
- what are the key interests of the client to protect? (control, exit, rights to IPR, dividend return?)
- how does the client expect to make a commercial return from the venture? (dividends, payments under ancillary contracts, capital gain on exit?)
- what rights of control or participation does the client expect?
- does the client need or have an exit strategy?

## SHAREHOLDER ISSUES

- Many JV transactions involve issues relating to 2 different phases of JV's existence: (a) setting-up phase involving disposal/acquisition-type issues; & (b) post-establishment phase involving ongoing shareholder-relationship issues.
- **Equity shares.** Ownership/voting shares will be vital:
- will it be a 50:50 deadlock JV – or will 1 have majority interest?
- will economic ownership & voting rights be the same?
- **Funding-** Crucial to establish parties' legal obligations re: capital contributions, both at outset and in future:
  - will initial capital be provided in cash/non cash assets?
  - initial debt/equity ratio?
  - obligations to contribute further capital, perhaps up to maximum limit and/or in defined tranches? or no obligation to commit future finance?

- shareholder loans?
- obligation to provide guarantees or counter-indemnities to support finance raised by the JV?
- by what authority/procedure are new issues of shares to be made – by mutual agreement or by majority decision of the SHs/board of directors? pro-rata offerings?
- outside finance? project finance to be secured on, and serviced from, the income stream of venture?
- VC funding? Rights of “drag along” or “tag along”).

Corporate governance – “managing  
ongoing agreement”

## Corporate governance (Co Go)

- Mgmt structure & Co Go rights usually be closely related to equity ownership. Key issues include:
  - rights to appoint directors;
  - who will appoint executive mgmt team?
  - what authority is to be given to individual managers (e.g. CEO)? what matters must be dealt with at board level?
  - what are to be “reserved matters” for decision by the SHs themselves – and/or will any “super-majority” vote be required for particular decisions at SH or board level?, e.g.:
  - changes in the JVC’s articles of association;
  - new issues of share capital (including grant of share options);
  - significant changes in nature of the business of the JVC;

## Co Go cont'd

- major acquisitions or disposals;
- capital expenditure or contract commitments in excess of pre-agreed limits;
- borrowing limits;
- dividend policy;
- appointment and dismissal of key management;
- material dealings with IPR;
- dealings between JVC and its SHs (except arms' length dealings in ordinary course of business).



# Minority protection

- If a minority interest, wish to protect its interests.
- Objectives may include:
  - to participate in management through board representation;
  - to be involved in major decisions (including, possibly, a right of veto);
  - to protect against its equity stake being improperly diluted;
  - to ensure proper distribution of profits;
  - to establish adequate access to information regarding the JV's affairs;
  - to establish “exit” routes (including, possibly, put option rights or “tag along” rights).
- The interests of minority/ies will need to be reconciled w those of majority participant.
- *Different majority objectives: to control management appointments; to minimise minority veto rights; and frequently, to establish “drag along” or other rights to enable it to deliver a sale of the JV as a whole to a third party.*
- A balance will have to be struck!

# Additional matters

- **Non-compete.** if actual or potential competitors. Establishing clearly its scope is vital and will often be contentious in detail:
  - scope (territory/field) of restriction;
  - exceptions (e.g. freedom to make acquisitions of businesses not significantly in competing field – possibly subject to offering the competing business to the JV)
- **Dividend policy.** Need a common understanding re: distribution policy to be adopted. Particularly if a participant is a minority SH, it will have little control subsequently and future dividend policy can cause considerable friction.
- **Ask: Should there be requirement to distribute minimum proportion of distributable profits?**



## Exit

- *When, and how, should a party be able to exit or terminate its interest in the joint venture?* Parties are often reluctant to discuss possibility of break-up or termination, but should provide for it.
- Basic exit or termination scenarios include:
- **unilateral exit or termination:** right to sell to a 3d party purchaser subject to right of pre-emption in favour of continuing party(ies). Sometimes, it will not be feasible to permit transfer without consent of the other SH(s); question then is whether a party should have a right to compel liquidation in certain circumstances;
- **termination for cause** or bx of a “**trigger event**”. If agreed that particular event triggers right of another party to use call option or other termination procedure, “trigger event” needs to be carefully defined, e.g.
  - insolvency;
  - change of control? (can be material and contentious, esp. if JV comprises a significant part of a party’s business);
  - material breach? (esp. where funding commitments significant);
  - deadlock (we’ll touch upon later).



- **Put/call options.** Sometimes agreed that 1 party will have right, at specified time and usually at specified price or at a third party valuation, to “put” its shares or a right to “call” for the other party’s shares.
- **Pre-emption rights.** common - whereby, prior to proposed transfer to 3d party, the other SH(s) are given a pre-emption right. Points which arise include:
  - price may be set by reference to a price which an identified third party purchaser is prepared to pay (the continuing party w **a right of first refusal**); or a price proposed by transferor before it finds a third party purchaser (continuing party having **a right of first offer** at that price); or a price determined by 3d party valuer (establish the valuation criteria, esp. control premium);
  - if a majority party wishes to sell, should it be entitled to “**drag along**” minority party so that it can deliver the whole JVC to 3d party?;
  - should minority party have right to “**tag along**” or “**piggy-back**”?

# Additional questions

- **Deadlock resolution:** inherent prospect of mgmt deadlock. Schools of thought differ re: formal deadlock resolution mechanisms (at times w a 3d party non-executive 'swing' vote).
- Common formula: any deadlock/dispute is escalated to chairmen/chief executives of JV participants – or, perhaps, an intermediate panel of execs – or subject to formal mediation.
- If prolonged & fundamental dispute, maybe include specific 'divorce' mechanism like right to terminate & **initiate liquidation**; or commence a “**shoot-out**” **procedure** (e.g. a “Russian roulette” or “Texas shoot-out” procedure) between parties as a result of which 1 party will buy out other.

# Additional questions

- **Business plan:** ensure parties “own” common & clear (common to attach opening business plan in JV agreement).  
Legal validity?
- **Accounting policies:** establish accounting principles & policies to be adopted by JV in subsequent accounts (particular issues such as depreciation/amortisation policy can cause potential conflict). Resolution should be given a high priority. Who are venturors???
- **Law/arbitration.** The governing law should be established early. It will often affect the choice and role of the particular lawyers.
- Also, should litigation or arbitration decide any disputes regarding the rights or obligations of parties?
- Arbitration will often offer advantage (in addition to greater privacy) of more effective enforcement internationally of awards v-à-v New York Convention 1958.

# STRUCTURE

- Early issue for us lawyers will be to establish the **legal structure** for JV.
- In many cases this is obvious. In others, it requires careful analysis & planning.
- Early work is vital, as it will significantly affect choice/use of lawyers and documents' drafting. Choice of structure will depend on variety of factors with different weight according to circumstances of that particular venture.
- Key considerations will be:
  - tax (as regards location, establishment of the joint venture, ongoing operations, repatriation of profits etc);
  - the importance attached to liability limitation;
  - likely treatment under competition/regulatory laws;
  - accounting treatment (will the JV be a subsidiary undertaking? will it need to be consolidated in the parent's accounts?);
  - need for a clear management or employment structure;
  - formalities of formation and publicity/administrative requirements;
  - need for an entity which will enable subsequent transfers of interest to third parties – or introduction of new SHs?
  - ease of unwind-liquidation.

# JV basic form options

- The basic formal categories are:
  - (a) contractual JVs, (b) partnerships and
  - (c) corporate joint ventures.
- **Corporate joint ventures.**
  - most common JV form to carry on ongoing business.
  - Corp structure generally offers advantages such as: identity; limited liability; more opportunities for financing; continuity in event of transfers; flexibility of share rights; established laws/cases/jurisprudence=legal certainty.
  - Contra: certain additional publicity, formality and compliance/filing requirements...



# Corporate JV options

- Most common form = **company limited by shares** (usually private company, or equivalent, unless public offering planned later);
- Ltd, Inc., GmbH, SL, Ltda., SA (private), SAS, Sàrl, BV, etc.
- Versus: PLC, SA, SA, SA (public), AG, NV
- An **unlimited company** may have tax advantages in some jurisdictions; each member having unlimited liability;
- A **European Company (SE)** (*Societas Europaea*, public limited company) can be formed; likely to have limitations but may offer some attractions as a vehicle for cross-border JVs in some circumstances.
- **Partnerships**: recognised form in most jurisdictions (relatively rare in UK for ongoing commercial business). Primary feature is they are a “fiscally transparent” / “pass through” vehicle for tax purposes –

# Partnerships

- the UK, the most common form is a **general partnership**;
- - a **limited partnership** may exist of limited partners (with limited liability) with at least one general partner (with unlimited liability). In the UK, a limited partner will lose the benefit of limited liability if it becomes involved in the management of the partnership.
- - the UK has now introduced a form of **limited liability partnership** (see under “Hybrid vehicles” below).
- - in **civil law countries**, other types of partnerships exist and may be more commonly used than in the UK (e.g. the GmbH & Co KG in Germany which is a limited partnership with a GmbH acting as the general partner).

# JV options cont'd: Hybrid vehicles

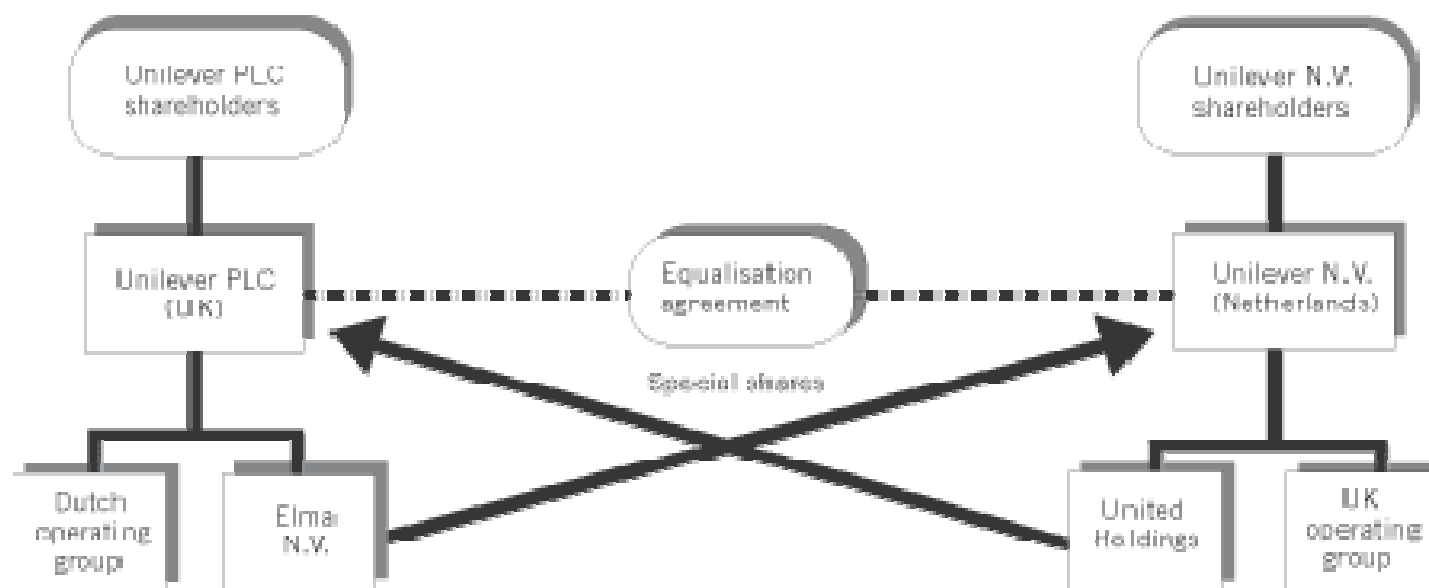
- Other vehicles / structures appropriate in certain circumstances:
  - **European Economic Interest Grouping (EEIG):** suitable medium for an EU cross-border alliance where primary purpose is not to carry on profit-making business (e.g. cross-border R&D collaborations & other industry associations); must have members in at least 2 EU countries. No single member can hold a majority vote; an EEIG cannot have more than 500 employees; new members require unanimous approval; members of an EEIG have unlimited liability; and its activities must be ancillary to those of its members. EEIGs must be registered in an individual MS.
  - **LLC.** If US involved- some choose incorporation in Delaware as limited liability company (**LLC**). “Freedom of incorporation” & flexible set up and mgmt.
  - + since LLC may elect (“checking the box”) to be taxed in US either as a corporation or a partnership.

# Entity options cont'd

- **Limited liability partnerships (LLP)**. US/UK- really a corporate with a separate legal standing. Each partner has limited liability but w advantage that an LLP is “tax transparent” and is treated for tax purposes as a partnership (i.e. profits & losses accrue directly to members pro rata). An LLP can carry on any type of business in UK. Dealings between members governed by “membership agreement”. Public filing requirements (e.g. annual accounts etc) similar basis to that of limited company.

# “Dual-headed” structures

- In some cases, cos may wish to conduct combined business through a single merged venture for mgmt purposes but, for tax reasons or for corp identities, also wish to maintain their existing national companies.
- These “dual headed structures” have usually been established by publicly listed companies (owned by different sets of SHs in each national entity respectively) but with contractual links so that 2 companies can be run as a single business enterprise – such agmt covering mgmt; accounting; profit sharing or equalisation; distribution; repayment of capital or liquidation proceeds.
- E.g. Carnival-P&O



The Unilever group has operated as one unit since 1929. However, the top tier companies and their respective subsidiaries have remained as separate entities. Unilever PLC is listed on the London Stock Exchange and Unilever N.V. is listed on the Amsterdam Stock Exchange.

The two top tier companies operate together as one company, with identical boards of directors and accounting principles and they prepare group accounts.

The top tier companies are unable to adopt different distribution policies regardless of relative profit performance and exchange rate movements. The equalisation agreement between them seeks to ensure the position of shareholders of both companies is as close as possible, so that it is as if they hold shares in a single company. The shareholders of both companies should, therefore, receive the same dividends.

# Strategic alliance

- “Alliance” often used to describe a form of contractual cooperation between firms in technical, operational and/or commercial areas – but which does not establish a separate business entity.
- Many established on very loose basis. In some cases, a strategic alliance will be cemented further by **equity investment** by 1 party in the other, giving rise to issues of board representation, etc.

# Strategic alliance





# Contractual joint venture

- Many JVs established as unincorporated ventures based simply on a contract between parties detailing cooperation & without creation of an independent legal entity.
- This form is usually more appropriate for short-term, single purpose ventures or those established for cost-sharing purposes (e.g. collaboration on joint R&D or a consortium to undertake a particular works project).
- The contractual route is flexible but will depend on detailed contractual provisions to define relationship.
- NB In many cases, contractual arrangements may well constitute a “partnership” in law.

# Parallel joint ventures

- In an international JV, there may be occasions when it is preferable to establish a different JV vehicle in a number of countries – rather than single JV co to act as holdco for a number of subsidiaries located in different jurisdictions. This will often be determined by tax factors.

# DISPOSAL/ACQUISITION-TYPE ISSUES

- Where JV involves merger of significant businesses/assets to be contributed by each of JV parties, transaction will raise number of issues equivalent to those in any private acquisition/disposal transaction.
- Particular issues which frequently arise in JV transaction include:
- **What business/assets are being contributed?**
- **Shares or assets or both?** Affects type of documentation required to contribute the shares/assets – and often approach re: responsibility for pre-merger liabilities.
- **Due diligence.** Will often be as necessary, & similar, as in an acquisition – arguably, even more important since v. difficult commercially, except in extreme situations, to pursue legal claim for breach of warranty against JV party.
- **Valuation.** Have appropriate valuation mechanisms been agreed to establish respective “value” attributed to each’s contribution? This may become major commercial negotiation → involve outside financial advisers to assist in complex & sensitive negotiations.
- Usually necessary where listed co entering into major JV, to ensure transaction fair re: value for its SHs.

# Value equalisation

- Where parties wish to retain 50:50 equity split, or other fixed equity ratios, need to agree mechanisms to “equalise” valuation gap. Possible mechanisms include:
  - cash payment by one party to other (but consider tax treatment);
  - additional cash contribution to the JV;
  - “excess” to be represented as a SH loan rather than equity;
  - borrowing by the JV so that it can pay for “excess” in cash;
  - extra management/service charges;
  - leasing/adjustment of assets;
  - disproportionate distribution of dividends for a period.

# Warranties/indemnities

- Negotiated substantially as for SPAs; should generally be restricted to significant matters affecting other party's contribution or financial performance of JV. Matters commonly addressed :
  - capacity/authorisation;
  - title to assets being contributed;
  - no material litigation;
  - no material undisclosed liabilities (including product liabilities);
  - all requisite governmental / regulatory approvals obtained;
  - contributed business having been conducted in material compliance with all relevant laws → also BRIBERY and TRADE SANCTIONS

# Warranties/indemnities cont'd

- validity of IPR & no infringement claims by 3d parties;
- accounts give true & fair view/reasonableness of mgmt accounts or other financial info;
- no material adverse change; (MAC/MAE clauses)
- accuracy of key info disclosed;
- tax warranty/indemnity re: no liabilities to be assumed by JV for past trading or events;
- appropriate environmental warranties or indemnities.
- Warranties usually subject to time / amount limits

# IPR issues

- **Intellectual property/technology is fundamental**
- What rights are to be contributed to JV?
- Will JV parties retain ownership or a licence to use IPR outside scope of the joint venture?
- Will they receive licences for use of IPR developed by JV itself?
- IPR filings and costs? Where?
- How will new IPR developed in JV be used, esp. w 3d parties?
- Importantly, what are to be rights of parties on termination (including on transfer) to IPR contributed to or developed by the joint venture?

# COUNTRY-SPECIFIC ISSUES

- JV must be founded in jurisdiction of 1 country, & national laws (& practice) will be important in relation to JV establishment.
- Issues should be identified at early stage which may require detailed investigation or which could require more lengthy/expensive attention.
- Issues which commonly arise include:
  - are foreign investment or other **governmental/regulatory approvals** required? what documentation or procedures involved?
  - are **central bank restrictions** or approvals required?
  - are there **restrictions on foreign participation** (including as to permitted % size of any shareholding) in relevant industry?



# Country-specific issues

- are there specific requirements for 3d party valuation of non-cash assets?
- will documents require to be **notarised (remember)**? will they need to be in **local language**? Which language controls?
- Generally, foreign law issues relevant, particularly in emerging markets, esp. re: tax; real property/land rights; environmental laws; capital requirements; mgmt structures/requirements for “local” mgmt; employment laws; protection of IPR; dispute resolution; repatriation of profits.
- Clarify whether (& which) **foreign lawyers** are to be instructed – & by whom. Don't wait until last minute!!

# TIMING ISSUES

- Vital early identification of **3d party consents** etc. involving lengthy lead times. Key to establish who does what – plus realistic timetable for consents or doing tasks should be done early on. Typical issues include:
- **Competition/anti-trust.** Joint ventures frequently require regulatory approval. It is vital to review at an early stage the likely regulatory impact on any venture. Regulatory approvals can include:
  - merger control: will notification or approval be required under the EU Merger Regulation (EU Merger Regulation, Council Regulation (EC) No 139/2004)?
  - foreign investment controls: in many countries, particularly in emerging markets, participation by a foreign company will require prior approval under foreign investment laws of the “local” jurisdiction.

# EU Merger Control

- Applies to “full-function” jointly-controlled ventures with a “Community dimension”, namely:
- where (i) combined aggregate worldwide turnover of parties exceeds €5bn & (ii) the Community-wide turnover of at least 2 parties exceeds €250m; or
- where (i) combined aggregate worldwide turnover of parties exceeds €2.5bn &
  - (ii) in at least 3 MSs, combined aggregate turnover of parties exceeds €100m & aggregate turnover of at least 2 of parties exceeds €25m &
  - (iii) aggregate Community-wide turnover of at least 2 parties exceeds €100m;
- unless, in either case, each party achieves more than 2/3 of its aggregate Community-wide turnover in 1 MS.

# Other key approvals

- **Industry-specific approvals.** Many regulated industries (licensing procedure), e.g.: banking; insurance; financial services; utilities; broadcasting; telecoms; mining; energy; arms; aerospace etc.
- **Stock Exchange/SH approval:** cos (particularly if securities listed/quoted publicly) must consider whether JV establishment requires prior approval from SHs &/or involves mandatory notification requirements.
- **Financing/borrowings.** Will JV involve transaction requiring prior consent of banks or trustees under terms of any loan agreements/lines of credit, debenture stocks or trust deeds?

# Other key approvals

- **Major contracts/customers.** As a commercial matter, often important to get comfort that major existing customers or suppliers will continue to deal w JV. In addition, creation of JV may mean that consent of counterparties to relevant contracts will be required – involving a need to identify: *major contracts where consent of counterparty (including, possibly, partners in other material JVs) is of such importance that it should be condition precedent of this JV going ahead...*

# Employees & Tax

- Key timing &/or political issues arise from requirement for consultation w employees or trade union representatives under employment legislation: requirements need to be identified & planned early .
- JV structuring often involves significant tax planning. Early involvement of tax lawyers is essential. Tax planning may entail rulings from tax authorities. Tax issues may include:
  - choice of JV structure (is a fiscally transparent JV vehicle desirable?);
  - choice of jurisdiction;
  - costs of establishing JV (esp., potential tax on capital gains on disposal of assets/shares contributed to JV may require careful planning);
  - repatriation of profits or “income access” shares;
  - tax affecting ongoing operations
  - tax on eventual disposal, transfer or termination.
  - **Valuation of non-cash assets.** If JV founded on contribution(s) of non-cash assets, many jurisdictions require formal procedures for valuation of those assets. If so, these procedures need to be identified early and built into timing.

# STEPS IN JV NEGOTIATIONS

- Not easy to put together or negotiate → each JV different. Plan broad “route map” identifying key legal steps & target timetable.
- Principal next steps to be identified at an early stage include:
- Has an appropriate **confidentiality agreement** been established?
- Are the parties entering into “**exclusivity**” **undertakings** not to negotiate with third parties? UK courts will for a defined period, enforce such obligation. UK court will not, however, enforce a positive obligation on a party to negotiate “in good faith” if it does not wish to do so. The position under many civil law systems may be different.
- Is it intended to set out the basic commercial principles in a **letter of intent, MoU, heads of terms** or similar document? In some cases, not necessary & time better spent on detail of definitive agmt.

# Steps, cont'd

- In many joint ventures, particularly cross-border ventures, an MoU can: enable senior negotiators to concentrate on establishing the fundamental principles; help to “seal” the fundamental undertaking and seriousness of partners; provide basis for any public announcements; provide a basis for approaches to regulatory authorities; help to keep the transaction moving; and/or provide a basis for drafting of the definitive agreements.
- Beware that, even if expressed not to be legally binding, in certain civil law jurisdictions an obligation can arise to negotiate in good faith which can give rise to liability (in most cases for expenses) in event of withdrawal from negotiations for unjustified reasons.



# Key considerations

- Decide re making an early **public announcement** and, if so, ensure review of press release. In the case of a listed company, eye announcement duties under stock exchange regulations.
- Clarify extent of **due diligence** or other pre-contract investigations are to take place.
- Due diligence may cover (a) financial matters, (b) legal due diligence, (c) property or environmental surveys, (d) tax, (e) commercial matters and/or (f) technology evaluation.
- NB it is essential early task to identify specific **consents & clearances** which will be required from 3d parties to establish JV.
- Very often, necessary to plan an internal **restructuring or reorganisation** of the relevant business to be contributed by each.
- Areas which may be involved include: contracts; properties; IP; interests in subsidiaries/JVs; employees; pensions; share options; guarantees/indemnities; and/or support arrangements (e.g. shared IT-telco systems, site support facilities, admin services, etc).

# “JV contractual universe”

- **ID principal drafting duties & target timetable.** Initially, confidentiality agmt and MoU, then possibly:
  - intra-group transfer agreements;
  - contribution agreement (if assets to be contributed);
  - shareholders’ agreement/ JV agreement;
  - memorandum and articles of association/by-laws of JVC;
  - IP/technology agreements (licensing);
  - administrative services;
  - supply/distributorship agreements;
  - transitional services;
  - other ancillary contracts, as needed....

# The End – Thank you

- Much credit should be given to one of the UK's foremost JV experts and former colleague at Freshfields, Ian Hewitt (I highly recommend all of his books)