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Joint Ventures

Selected legal considerations for long-term partnerships

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I. Executive Summary

Joint ventures are often considered when entering a new market or when there is a need for third party technology to fill a capabilities gap. They often require a significant investment of the joint venture partners and, consequently, significant attention of senior management.

This paper outlines selected considerations – primarily of a legal nature – that should be taken into account when contemplating the establishment of an incorporated joint venture. The focus lies on joint ventures between two corporate partners in the industrial sector.

In our experience, the level of involvement (in terms of financial resources and time) and the level of exposure (in terms of how sensitive or strategically important the joint venture's business is) of the joint venture partners are the key factors that significantly influence the legal aspects of a joint venture and the drivers for the structuring of a joint venture and consequently the joint venture agreement.

In 50:50 joint ventures key legal issues often arise in connection with (i) the setting up of the relationships between the joint venture company on the one hand and the joint venture partners or their affiliates on the other hand, (ii) the prevention or resolution of situations where the business of the joint venture company is affected by a disagreement between the joint venture partners with respect to material decisions (deadlocks), and (iii) the allocation of intellectual property rights among the parties and the joint venture company, in particular in case of an exit of one of the parties. Accordingly, we focus our considerations in this paper on these aspects.

With respect to situations where one joint venture partner is the minority shareholder in a joint venture, our considerations in this paper focus on the following three areas which frequently turn out as key negotiation issues: (i) the (potential) conflict between a requirement of the majority shareholder to consolidate the joint venture company in its accounts and the minority shareholder's request for veto rights and other protective measures, (ii) the means to ensure an appropriate level of influence of the minority shareholder on the day-to-day operations of the joint venture company, and (iii) the protection of the minority shareholder in connection with the exit of any joint venture partner.

II. Introduction

The reasons that lead companies to set up joint ventures are manifold. Joint ventures are often considered in case of a need for support of a reliable local partner when en-

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tering a new market in a foreign jurisdiction or when the technology of two independent partners is required to develop a new product or to perform a specific type of project. Joint ventures might also serve other goals, such as getting access to new resources and talent.

Joint Ventures typically require a significant investment of financial resources, time, and management attention. Despite the costs and the risks entailed[1] parties may consider joint ventures if a full takeover by way of an M&A transaction or an independent entry into a market through organic growth is viewed as too costly or time-consuming or not feasible for other reasons.

This paper outlines a selection of considerations that we have encountered while advising on a significant number of joint venture transactions, whereof twelve in eight jurisdictions since the beginning of 2017. We focus on legal considerations and topics with a significant legal impact. Of course, when considering the setting up of a joint venture, various non-legal aspects are of key importance, in particular the choice of a suitable partner and the careful assessment of cultural differences between the jurisdictions involved, but also between the corporate cultures of the joint venture partners. The latter is a good example to show that non-legal considerations often have a substantial impact notably on the negotiation phase, in particular when partners with a different cultural background or with a different level of past exposure to internationally accepted practices or standards, encounter difficulties in the context of the negotiations due to misunderstandings and emotional disputes over issues of minor importance. Such issues – whether or not material – can severely and adversely affect the spirit of the negotiations from the beginning.

III. Focus on Incorporated Joint Ventures between Two Corporate Partners

1. The Term «Joint Venture»

The term «joint venture» is not very precise. Neither is it defined by law or commonly accepted regulations nor is there – to our knowledge – a general understanding in legal doctrine or practice on the precise meaning of such term[2]. Typically, the term is used to describe a wide variety of cooperation or partnership arrangements between two or more parties. In most jurisdictions, such arrangements are primarily governed by corporate law, contract law, anti-trust law and tax law, depending on the specific features of the arrangement.

2. Corporate Joint Ventures vs. Consortiums

A main distinction, with a significant influence on the legal qualification and the applicable rules, can be made between incorporated joint ventures (so-called equity or corporate joint ventures), which have their own legal personality independent from the joint venture partners themselves, and purely contractual joint ventures (which we would typically call consortiums), which do not qualify as separate legal entities under applicable law. Most jurisdictions also allow the establishment of a type of joint venture that is somewhat in between an incorporated joint venture and a contractual joint venture, which is typically called a partnership, on which laws other than contract law applies, but which are not registered/incorporated as legal entities with their own legal personality.[3]

We often see joint venture partners – in particular if one of them is non-Swiss – tending to establish corporate joint ventures to conduct business in Switzerland.[4] With the exception of contractual consortiums established for the bidding and/or performance of specific government-related projects, we also see a tendency of Swiss companies to form corporate joint ventures with foreign partners when intending to enter markets abroad. The reasons for that are probably manifold, but often two elements are of key importance: the ability to limit the foreign partners' liability by establishing a local joint venture company in the form of a separate legal entity with limited liability of its shareholders, and the fact that the local joint venture company will often qualify as a domestic legal entity irrespective of its foreign share-

1 As regards the risks entailed with conducting a business through a joint venture, the following will typically rank among the main risk factors: (i) no partner can operate the joint venture solely for its own benefit, (ii) ownership and management of a company is shared among parties who may not have the same goals, strategies, priorities or resources, (iii) operating a business as a joint venture often requires additional organizational formalities, as well as time-consuming procedures for sharing information and making decisions, (iv) if a partner changes, this might significantly adversely affect the joint venture's business, (v) access to the cash flows of the joint venture company typically requires the consent of the joint venture partners, and (vi) it may be difficult to retain talented (key) employees in a joint venture structure. In some cases, the entering into a joint venture with a specific partner or with regards to a specific product might also restrict the joint venture partners' access to such product via other sources in case the joint venture proves to be unsuccessful.

2 See also Matthias Oertle, Das Gemeinschaftsunternehmen (Joint Venture) im schweizerischen Recht, Diss. Zurich 1990, in Schweizer Schriften zum Handels- und Wirtschaftsrecht, Band 132, 1.

3 Swiss law, for instance, provides for a simple partnership *(einfache Gesellschaft)* pursuant to article 530 et seq. of the Swiss Code of Obligations (SR 220), which has no legal personality.

4 See also Nedim Peter Vogt/Rolf Watter, Joint Ventures in Switzerland, Swiss Commerical Law Series, Vol. 4, 17.

holders.[5] However, also with regard to corporate joint ventures, the degree of autonomy from the joint venture partners and their affiliated groups may vary significantly. Certain joint ventures have only auxiliary function for the parent groups, for example as supplier for specific parts, while others are established to operate independently in a market on a long-term basis.

3. Two Partners vs. Several Partners

Another important distinction can be made between joint ventures with two partners and joint ventures among more than two partners. The latter may *e.g.* be the case when the technical expertise of various independent companies is required to perform a development or technology project, or when regulatory reasons or public tender requirements require a specific partner to be a party to a joint venture.[6] As a matter of principle, the more partners are involved, the higher the risk that one of them might underperform or that disputes between parties with deviating interests might evolve. Nevertheless, the consequences of disputes between partners or the failure of one partner might be easier to manage in joint ventures with more than two partners than in two-party joint ventures. In any case, the main legal and contractual means to ideally prevent – or at least mitigate the effects of – such issues are usually very different depending on whether there are two or more than two partners.[7]

We will focus our considerations in this paper on situations with two partners, given that this is the setup that is, in our experience, most often used when strategic partners enter into corporate joint ventures.

4. 50:50 vs. Majority/Minority

It is important to distinguish joint ventures in which each partner holds 50 percent of the capital and voting rights (or situations in which the participation is not exactly, but close to, 50:50)[8] from joint ventures with a (clear) majority and a minority shareholder. The participation ratio has a significant influence on many aspects, including the incentive to accrue profits in the joint venture company, the control over important decision of the joint venture company or the risk that the business of the company is affected due to the inability of the parties to agree on material operational aspects. In a 50:50 joint venture, the cooperative elements between the parties are typically even more important than in joint ventures with a clear majority and minority shareholder. The joint venture partner holding a majority participation typically also controls the joint venture company; along with the control usually comes an increased commitment (*e.g.*, in terms of financing the joint venture's activities and providing know-how/key personnel), while the minority joint venture partner often maintains more flexibility (*e.g.*, to exit the structure, or to reduce its financial commitment).

5. Economic Purpose

Legal concepts and contractual mechanisms applied in the joint venture documentation may deviate significantly depending on the economic purpose of a particular joint venture[9], *e.g.*, if it is entered into for a specific project in one market (or even with only one customer[10]) applying a limited set of technologies and using a limited amount of resources of the parties, or if the joint venture is intended as a long-term partnership on an exclusive basis, restricting the ability of the parties to collaborate with other partners, and that requires significant investments.

In connection with the negotiation of the joint venture agreement, a significant difference is typically noticeable between a situation where the joint venture serves the goal to correct deficiencies in the ability of one of the joint venture partners to perform certain functions, i.e. if the goal is to fill a capabilities gap, and a setup which is about leveraging existing capabilities. In the former case, the bargaining power of the concerned party is typically reduced.

Further, joint ventures may be *horizontal,* i.e. between partners active in the same area of business in terms of

5 With respect to the second element, see also Vogt/Watter (FN 4), 17, with the additional remark that this may be especially helpful where the joint venture company bids for public works.

6 In public tenders for infrastructure projects, in particular in emerging markets, we regularly see requirements to involve state-owned companies as shareholders of a joint venture company bidding for the project, often to allow a certain level of access to know-how and intellectual property rights. Usually, such tenders also contain a standard form of a joint venture agreement to be entered into by the successful bidder(s) and the state-owned company, with a fully-fledged set of (minority protection) rights of the state-owned company.

7 A third partner may serve as deciding voice in case of disputes/deadlocks, and it may be easier to continue the joint venture between the remaining partners if one partner leaves the joint venture as opposed to involving a new partner in a two-party joint venture after the exit of one of the founding partners.

8 *E.g.,* if for regulatory reasons, the local partner of a foreign company is required to hold more than 50 % of the capital and voting rights (50 % plus one share). We have recently experienced such scenarios in connection with the setting up of joint ventures for the bidding for large infrastructure projects in Turkey and India. Similar restrictions apply in China with respect to certain business areas.

9 See Oertle (FN 2), 10 et seq.

10 In connection with large infrastructure projects, joint venture partners regularly choose to incorporate corporate joint venture companies for the entering into and performance of the project agreement with the customer, if the applicable bid regulations allow (which often entails that the joint venture partners provide sufficient security for the performance of the obligations of the joint venture company, *e.g.*, parent guarantees or bank guarantees).

production chain, or *vertical*, i.e. between partners active in different levels of the production chain.[11]

IV. Structuring Considerations

1. Level of Participation

At an early stage of the discussions regarding a potential collaboration, the parties will have to consider how to structure their potential partnership. A key consideration in this context is whether to go for a majority or minority position in the joint venture or to have both partners hold the same number of shares, unless, of course, the economic background or the circumstances clearly suggest that one partner acts as the controlling/majority shareholder in the joint venture company.

The following considerations may be of relevance for the decision whether to aim for a majority or minority position or 50:50 setup[12]:

- *Legal/Compliance:* Do we want to control the shareholders meeting and/or the board of directors and/or the management of the joint venture company? Do we want to exercise direct control over the actions taken in connection with the day-to-day operations of the joint venture company? Do we need to maintain control over intellectual property rights/knowhow/sensitive data transferred to or developed by the joint venture company?
- *Accounting/Tax:* Do we want to be able to consolidate the joint venture company for accounting purposes? What level of participation is preferable from a taxation viewpoint?
- *Business/Commercial:* With what share do we want to participate in profits (and potentially losses) of the joint venture company? How closely do we want or are we able to be involved in the day-to-day operations of the joint venture company?
- *Reputational/Branding:* Do we want the joint venture company to be perceived as «our» subsidiary? Do we want to be directly connected to the business the joint venture company is engaged in? Do we want our name/brand to be used by the joint venture company?

2. Merger Control Aspects

The level of participation and the degree of autonomy of the joint venture partners also have an influence on the qualification of the joint venture from an anti-trust point of view. In most jurisdictions, the establishment of a (corporate) joint venture needs to be notified to competition authorities if certain turnover thresholds of the joint venture partners are met. On the one hand, the establishment/incorporation of a joint venture by two or more companies may qualify as a notifiable concentration within the meaning of the anti-trust law. On the other hand, a situation where two or more companies acquire joint control over an existing business which they previously did not jointly control is also deemed as concentration.[13] However, Swiss as well as European law only qualify joint ventures as concentrations if they perform all the functions of an autonomous economic entity on a lasting basis (so-called full-function joint venture). To qualify as full-functional, a joint venture needs to have sufficient human and financial resources to operate independently in a market. Where a joint venture is newly established, it is further required that business activities from at least one of the controlling shareholders are transferred to the joint venture.[14] However, even if the joint venture is not qualified as full-functional, it may be assessed under the anti-trust rules applicable to agreements between independent parties.[15] Furthermore, there are some jurisdictions where full-functionality is not a prerequisite for a requirement to notify.

Typically, an assessment with respect to potential merger control filing requirements is conducted by an external counsel on a worldwide basis at an early stage of the discussions between the joint venture partners, and the actual filings, to the extent required, are made in the phase between signing of the transaction/investment agreement and the establishment of the joint venture company. If no in-depth review is required, which often is the case if there is no significant overlap between the areas of activities of the joint venture partners in specific jurisdictions, such merger control (notification) proceedings usually do not require more than two months to complete. The parties will often jointly engage an external counsel to conduct the merger control assessment, and do the same with respect to local counsel in specific jurisdictions in which filings are required. Turnover figures and other sensitive information required for the filings will then be shared by each party on an «attorneys-only» basis with such counsels, and the costs of the filings (including the fees of the external counsels) will be shared between the joint venture parties.

In Switzerland, according to article 9 of the Federal Act on Cartels and other Restrains of Competition[16], a

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11 See for instance Rudolf Tschäni/Hans-Jakob Diem/Matthias Wolf, M&A-Transaktionen nach Schweizer Recht, 2. Aufl., Zürich/Basel/Genf 2013, 316, and Oertle (FN 2), 13 et seq.

12 Tschäni/Diem/Wolf (FN 11), 316, consider 50:50 joint ventures to be more susceptible for conflicts.

13 See Rolf H. Weber/Stephanie Volz, Fachhandbuch Wettbewerbsrecht, Zurich 2013, N 2.824.

14 Art. 2 of the Merger Control Ordinance, MCO, of 17 June 1996 (SR 251.4).

15 Weber/Volz (FN 13), N 2.894.

16 Cartel Act, CartA, of 6 October 1995 (SR 251).

planned merger of enterprises by way of a joint venture must be notified to the Swiss Competition Commission if the following thresholds are met: (i) the worldwide joint revenue of the joint venture partners is at least CHF 2 billion or the revenue in Switzerland is at least CHF 500 million, and (ii) at least two of the involved undertakings each reported a revenue in Switzerland of at least CHF 100 million.

Nevertheless, if a joint venture is not regarded as full-functional, competition law may still have to be taken into account when structuring the relationships between the joint venture company and the joint venture partners, or between the joint venture partners themselves, because it provides for certain limitations with regard to sharing of information (in particular, any sharing of information outside of the scope of business of the joint venture company), the setting of prices, and the entering into of non-compete undertakings.[17]

3. Level of Involvement and Exposure

3.1 Significance of the Joint Venture's Business

As a matter of principle, it is fair to say that the more involved the joint venture partners are (in terms of time, financial resources, reputation, and allocation of resources), or the more the joint venture is of strategic importance to them and exposes their core businesses to significant risks, the more important the contractual protection of their interests from the beginning of the cooperation becomes. The drafting of the contractual arrangements governing the relationship between the joint venture partners therefore significantly depends on how close the relationship between the joint venture partners is supposed to become and how severely a failure of the joint venture could harm a joint venture partner's existing business.

3.2 Timing Aspect

It is often difficult to assess already at the stage of discussions and negotiations regarding a potential partnership whether the selected partner is indeed the right one for the contemplated project in the long run. Against this background, and if circumstances allow (*e.g.*, no significant upfront investment is required, no regulatory reasons require a long-term partnership), partners may consider to agree on a «testing phase» of a few years after which each party has the right to terminate the cooperation – *e.g.,* by winding up the joint venture company or by selling its shares to the other party – if the results achieved are not satisfactory or for any other reason. Where at all possible, such an arrangement often helps to deblock and simplify negotiations from the beginning and to avoid parties negotiating their further collaboration in too much detail and trying to agree on every potential scenario that may or may not occur in the future.[18]

However, in particular if one party has to make a significant upfront investment into the joint venture, which can be of a financial nature but also result from the need to contribute sensitive intellectual property or know-how that may to some extent be irreversible, it will often want to ensure that the other party is not in a position to terminate the joint venture and use the acquired benefits for its own purposes already after a short period of time, but that the other party is obligated to continue to invest its own resources in the joint venture for at least as long as required to justify the upfront investment of the contributing party. From a contractual point of view, this can for instance be achieved by stipulating lock-up undertakings of the parties, i.e. to prohibit share transfers for a certain period of time. Such lock-ups often provide for limited carve-outs, in particular for certain put or call rights exercisable upon the occurrence of triggering events such as material breaches of the joint venture agreement or upon a change of control. Sometimes, parties may feel sufficiently comfortable by stipulating transfer restrictions that significantly restrict an exit, in particular by prohibiting transfers to competitors or requiring a transferee to have certain specific abilities/resources.

The closer the relationship between the partners (or between the partners on the one hand and the joint venture company on the other hand) is intended to become, in particular regarding exclusivity and the restriction of the partners not to compete with the joint venture company[19], the more important will it be for each partner to ensure a certain level of influence on the scope of the joint venture's activities, both in terms of the business that it engages in and the territory in which the activities occur.[20]

17 See the following section IV.3 for more details.

18 Such a mechanism may have helped avoiding certain issues that arose in connection with the joint venture between Swatch and Tiffany that was the subject of a dispute described in Urs Schenker, Joint Ventures: Win/Win oder Lose/Lose – Swatch und Tiffany als Partner, GesKR 2015, 547 ff., where the parties apparently did not have to make a significant upfront investment and where it became soon apparent that the partners did not match.

19 The value of a joint venture for the parties may depend significantly on the scope of activities that the parties are prohibited from undertaking during the term of the joint venture; see also Georg Rauber, Internet Joint Ventures, in: Rolf H. Weber/Reto M. Hilty/Rolf auf der Maur (Hrsg.), Geschäftsplattform Internet, Publikationen aus dem Zentrum für Informations- und Kommunikationsrecht der Universität Zürich, Band 10, Zürich 2000, 169 ff., 201.

20 See also Dieter Gericke/Luca Dalla Torre, Joint Ventures – Wirtschaftsformen im Spannungsfeld zwischen Kooperation und Transaktion, in: Peter V. Kunz/Florian S. Jörg/Oliver Arter (Hrsg.), Entwicklungen im Gesellschaftsrecht VII, Bern 2012, 19 ff., 30 and Tschäni/Diem/Wolf (FN 11), 322.

3.3 Competition Law Aspects

Joint venture partners typically aim to precisely distinguish the areas of business of the joint venture company from their own business activities by clearly defining the activities to be conducted by each partner individually from those jointly engaged through the joint venture company. The joint venture agreement will typically set forth the scope of business of the joint venture company and provide for an undertaking of each joint venture partner not to compete the joint venture company in these areas.

Competition law, however, sets certain limits to the ability of the joint venture partners to agree on non-compete undertakings. The main question is whether such clauses are directly related and objectively necessary (ancillary) to the implementation of the transaction.[21] To comply with competition laws, parties will need to ensure that the geographical scope, duration, subject matter and the personal scope of application of any non-compete undertakings do not exceed what is reasonably necessary to achieve the goals of the transaction.[22] In any case, any non-compete undertakings are usually only considered ancillary for the lifetime of the joint venture; undertakings restricting the ability to compete following termination of the joint venture may only very rarely be regarded as ancillary and, thus, in compliance with applicable competition laws.

3.4 Scope of Non-Compete or Exclusivity Undertakings

If the joint venture agreement provides for an undertaking of each joint venture partner not to compete the joint venture company in its areas of business, each party will want to ensure that the scope of such non-compete or exclusivity undertakings is controllable/manageable and cannot unilaterally be broadened or limited by another party. Means that are often employed to achieve this outcome include the following:

- *Jointly agreed business plan:* The parties agree on a business plan for the first years of the joint venture company and undertake to update such business plan by mutual consent from time to time.[23] The business plan will, in addition to the financial plan, also address certain strategic decisions (*e.g.*, R&D/product line/markets) that form the basis for the activity of the board and management of the joint venture company. This is supposed to ensure that the joint venture company will not engage in activities that have not originally been agreed or subsequently been added by joint decision of the parties. Depending on the wording of the undertakings regarding the business plan, the parties will have to consider that they might be required to use a certain standard of efforts to achieve the targets set therein.[24] The parties might also want to consider specifically stipulating remedies or measures – such as *e.g.* changes to the management composition or additional funding to be provided by the parties – to be taken if the milestones in the business plan are not reached, or to clearly state that no such obligations shall apply.[25] The business plan will often also serve as the framework for the (ordinary) funding obligations of the parties.[26]
- *Veto rights on business extensions:* The parties grant each other the right to veto any decisions that lead to an extension of the company's business, in particular decisions regarding product lines, the entering of new (regional) markets, and the use or development of new technology.
- *Carve-outs for underperformance:* If the joint venture proves to be unsuccessful with respect to certain markets or customers after a certain period of time, the parties may want to service such market or customer themselves without involving the joint venture company. The reasons for such a situation may be manifold, but often they come from technical difficulties or requirements of a specific customer (or simply the customer's preference not to contract with the joint venture company for whatever reasons). To avoid the joint venture partners losing business in such a scenario, they may agree on certain limited carve-outs from their non-compete and exclusivity undertakings, *e.g.*, that these undertakings cease to apply with respect to specific markets, territories or customers if the turnover of the joint venture company with respect to such markets/territories/customers falls below a certain threshold during a certain period of time despite the parties complying with the standard of effort stipulated in the joint venture agreement. If the turnover in the relevant area rises again, the restrictions may kick in again for future business (carving out business directly entered into by the parties during the time when the restrictions did not apply). To some extent comparable with this scenario is a provision that grants the joint venture company

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21 Weber/Volz (FN 13), N 2.969 et seq.

22 Jürg Borer/Juhani Kostka, Art. 32 N 89, in: Amstutz Marc/Reinert Mani (Hrsg.), Basler Kommentar Kartellgesetz, Basel 2007.

23 See Gericke/Dalla Torre (FN 20), 31, pursuant to which parties often agree on an annual review of the business plan to allow a tight supervision.

24 See for instance the case described by Schenker (FN 18), I.6, where the arbitrators apparently were of the view that the contractual arrangements regarding the business plan of the joint venture company contained an implied undertaking to use reasonable efforts to achieve the turnover figures set forth therein.

25 See also Schenker (FN 18), II.2, who advises to exclude any liability for lost profits in connection with an underachievement of the business plan from the beginning, and/or to specifically stipulate in the contract that no party is responsible for the achievement of the milestones.

26 See also Gericke/Dalla Torre (FN 20), 52 et seq.

a «pre-emption right» for new business within its pre-agreed scope of activity, but allows the parties to pursue such opportunity on their own if the joint venture company decides not to pursue it following a pre-agreed process (*e.g.*, by a decision of its board of directors to be taken with the abstention of the members designated by the party proposing the new business opportunity).

4. Organization

Parties often tend to organize the joint venture company using a two-tier management structure: on the one hand the board of directors, composed of top management personnel of each joint venture partner's group, with a primary responsibility for strategic decisions and other material decisions that may have a significant financial impact on the future of the joint venture, and on the other hand the executive management with overall responsibility for the day-to-day operational aspects of the joint venture company, which is not necessarily composed equally, but primarily based on relevant sector experience, technical knowhow, and local expertise and network. Accordingly, it is important to agree on the composition of the management and the responsibilities of each management position (and the interaction between different functions) already in the joint venture agreement (or the organizational regulations, which will often be attached to the joint venture agreement, and which may only be amended with the joint consent of both joint venture partners).[27] Also topics such as the granting of single or joint signing authority to the members of the (top) management, in particular the CEO, may be delicate depending on the cultural background of the joint venture partners involved, and should ideally be addressed before the implementation phase to avoid negative influences on the atmosphere in the starting phase when a positive drive is key.

In our experience, parties have recently more often used structures with two levels where a joint venture holding company is established between the two joint venture partners, which may well be located in a jurisdiction where the joint venture will not necessarily do business, but which the partners are familiar with, and with one or more subsidiaries located in the jurisdictions/markets/regions, where the joint venture is operationally active. This allows the joint venture to be present locally and to have the flexibility to involve different (local) partners with an equity participation on subsidiary level while maintaining the balance of rights and obligations agreed on holding company level between the two (primary) joint venture partners. Typically, the joint venture agreement on holding company level will already provide for such a structure (even if the subsidiaries may not be established from the beginning and/or the parties may not yet know where the joint venture will become active from time to time) and stipulate that the governance rights agreed between the parties on holding level will be mirrored, to the extent local laws allow, in the whole joint venture structure. Usually, local laws will permit veto rights and board representation rights to be satisfactorily reflected – by way of pooling arrangements, different share classes, or the like – even if a third party is involved on subsidiary level and the joint venture partners do not hold 100 percent of the shares of the local subsidiary. Such a structure will of course require a thorough analysis from a tax structuring viewpoint, but in our experience there usually is a way to avoid a significant adverse taxation impact resulting from the two-level structure.

V. 50:50 Joint Ventures: Selected Key Legal Issues

There are of course various issues that may arise in the context of a 50:50 joint venture, and most of them do not only apply to 50:50 situations, but also to joint ventures structured differently. The following is a selection of key issues with a legal implication that we have come across in recent transactions.[28]

1. Relationships with Joint Venture Partners

In particular in the case of 50:50 joint ventures with no controlling joint venture partner it is key to specifically address not only the relationship between the joint venture partners regarding the joint venture company, but also the relationships between each partner (or its affiliates) and the joint venture company, i.e. the «commercial framework» to apply to any commercial dealings between the joint venture partners, related persons, and the joint venture company. The arrangements governing such commercial framework are often referred to as satellite or ancillary agreements. The commercial framework agreements will set forth the commercial terms applicable to *e.g.* the supply or customer relationship between the joint venture partners and the operating joint venture company, depending on its economic purpose. In this context typically issues arise with respect to profit allocation (shifting of margins between the joint venture company and the partners who are acting as suppliers or

[27] See also Rudolf Tschäni, Joint Ventures – Zivilrechtliche Probleme, in: Rudolf Tschäni (Hrsg.), Mergers & Acquisitions III, Zürich 2001, 51 ff., 66.

[28] Given the individual nature of joint venture transactions, it is difficult to identify any specific legal concepts as typical or standard for joint venture agreements. See also Rauber (FN 19), 194.

customers to the joint venture company), the transfer of intellectual property rights or the granting of licenses (typically providing for royalties given that rules on taxation of deemed dividends usually require that contracts be made at arm's length[29]) and often have a significant impact on the «life» of the joint venture. This not only applies if a joint venture partner is supplying the joint venture company with material components or technology for its products, but also for instance if one of the partners or any of its affiliates is providing the joint venture company with financing for its activities.[30] Accordingly, the parties will often require that all joint venture partners' consent to agreements between the joint venture company and any of the joint venture partners or their affiliates.

Unless specifically regulated otherwise in the joint venture agreement or the commercial framework agreements, any non-performance or underperformance of one party under the commercial framework agreement will usually not give the other party any rights under the joint venture agreement; in 50:50 joint ventures certain exceptions might apply as it may not be appropriate for the other party to be obligated to perform irrespective of the non-performance of its joint venture partner.[31] Typically, but not necessarily in each case, the commercial framework agreements will provide that they terminate with respect to any party if such party ceases to be a member of the joint venture.[32]

Given the commercial importance during the life of the joint venture, it is usually necessary to agree on the commercial framework – or at least its key aspects – between the joint venture company on the one hand and any joint venture partner or any of their affiliates on the other hand simultaneously with the entering into of the joint venture agreement, or earlier if an investment or transaction agreement is signed (unless it provides for a respective condition precedent to closing). While the terms of the joint venture agreement may be rather standard in some cases, the commercial terms of the supply, services or customer agreements between the joint venture partners on the one hand and the joint venture company on the other hand are often singular and, thus, may be a source for lengthy negotiations and commercial disagreements.

2. Deadlocks

Another characteristic of 50:50 joint ventures is that the parties should agree on certain deadlock resolution mechanisms applicable in cases where the joint venture agreement requires the approval of both joint venture partners for certain material decisions and they fail to reach an agreement. Nevertheless, deadlocks may of course also occur in joint ventures with a clear majority and minority shareholder, in particular if the minority shareholder is granted meaningful veto rights to block certain material decisions, which is often a key element of the minority protection mechanisms agreed in joint venture agreements.[33] However, especially in 50:50 joint ventures the fragile balance between two equally influential partners may be disrupted if the business is not running as well as expected. Such a scenario may be easier to resolve if one partner is in charge of the issue («in control») and can be held accountable by the other. It is more difficult to resolve such situations when accountability is not as clear, in particular due to a tendency of both partners to consider the other as primarily responsible for any issue that arises.[34]

There are plenty of mechanisms to resolve deadlocks from which parties can choose. In rare cases the parties agree to a form of arbitration procedure, in which each party may *e.g.* elect an additional board member who will in turn propose a third member; the newly composed board of directors will then decide on the issue. It is equally rare for agreements to provide that one party will prevail on certain questions in one year, while the other will in the next.[35] Sometimes, other mechanisms are considered such as the casting vote of the chairman of the board of directors of the joint venture company, the election of an expert/independent arbitrator, or if the deadlock relates to the board of directors, the election of an (additional) independent board member, or a combination thereof.[36]

More often we see a two-stage procedure with an escalation to the CEOs of the joint venture partners' groups as a first stage, which often proves efficient because it compels lower level management to act pragmatically in order to avoid the embarrassment of an escalation to their

[29] See also VOGT/WATTER (FN 4), 27.

[30] An arm's length credit agreement will typically contain various covenants of the joint venture company that might allow the lender to assert significant influence on the borrower, also regarding the conduct of its business, which might affect the balance of (control) rights agreed between the joint venture partners in the joint venture agreement.

[31] See TSCHÄNI (FN 27), 86.

[32] See also OERTLE (FN 2), 141 et seq. This is of course not a feasible mechanism if the services provided by the terminating party are required to fulfill the purposes of the joint venture company. If there is such a dependency on any joint venture partner, the joint venture agreement will have to ensure that no exit of such joint venture partner is possible without a proper wind-down of the joint venture company.

[33] See STEFAN KNOBLOCH, Joint Ventures: Vertrags- und gesellschaftsrechtliche Gestaltungsmöglichkeiten, GesKR 4/2013, 551 ff., 7.4.

[34] See also SCHENKER (FN 18), II.1.2, who refers to the issue that partnerships «invite» parties not to focus on solving the issue, but to shift responsibility to the other partner.

[35] See VOGT/WATTER (FN 4), 26.

[36] See TSCHÄNI (FN 27), 65, and TSCHÄNI/DIEM/WOLF (FN 11), 327.

superiors[37]. Mostly, this first stage, if unsuccessful after a certain period, will lead to a second stage providing for the winding up of the joint venture, not necessarily by liquidating the joint venture company, but by terminating the partnership between the joint venture partners in one way or another.

For such cases, parties often agree on put or call rights. These may be structured as *blind bids,* where both parties make an offer to each other simultaneously and the higher offer is successful, or the so-called *Russian Roulette* clause, where one party makes an offer and the other decides whether to buy or sell at the offered price. These mechanisms are destined to ensure that the shares change hand at a fair price.[38] The parties also often agree that pre-emption rights do not apply in connection with a potential sale to a third party if the price offered by such third party exceeds a certain pre-agreed minimum, given that third parties will often not be willing to spend time for, and allocate resources to, a sales process without being sure that no pre-emptive right will be exercised.[39] Ultimately, such two-stage deadlock resolution mechanisms will mostly trigger the winding down of the joint venture company, but their main benefit lies with the significant pressure they generate on the parties to find a common understanding.[40] However, they only work satisfactorily in practice, if the two joint venture partners have roughly the same financial strength.[41] In any case, appropriate contractual measures will have to be taken for preventing any party from arbitrarily triggering the deadlock resolution procedure in order to force an exit.

Where a put or call mechanism is not feasible because both partners are required for the ongoing conduct of the joint venture's business or the preservation of its value – be it for technical/know-how, commercial or regulatory reasons[42] – the parties will often aim to precisely allocate the areas where one of the partners has the final decision (after consulting the other in the course of a pre-agreed formal procedure), and to stipulate that the deciding partner will be liable if a unilateral decision results in damage to the joint venture company,[43] or they may resort to the involvement of a truly independent third party, be it an external expert or a board member (with deciding vote on board level and «binding» recommendation for decisions on shareholder level). The underlying principle, which we have seen working fairly well in practice, is to allocate the deciding power in certain sensitive areas to one of the partners while holding it accountable if its unilateral decisions turn out to be detrimental to the value of the joint venture company.

In connection with a wind-down of the joint venture company the goals typically are (i) to preserve the value of the joint venture and its developments, (ii) to allocate the remaining assets, rights and liabilities between the partners, and (iii) to compensate the parties for economical differences between each other arising from the wind-down.[44] Typically, time is an important aspect to avoid damage for the business, which is in particular caused by the focus of the attention of the strategic bodies and the management on the dispute as opposed to the day-to-day business of the joint venture company.

Against this background, the parties may chose not to provide for any ultimate deadlock resolution mechanism, in line with the underlying concept of veto rights whereas respective resolutions will not be taken if one party does not agree.[45] This is primarily an alternative regarding matters in respect of which a deadlock would not significantly adversely affect the going concern of the joint venture company, although one can assume that reasonable parties will in such a scenario find a solution to avoid damage to the company and their participations.[46]

Of course, ideally the joint venture agreement provides for effective means to *prevent* deadlocks (*e.g.,* by way of a precise allocation of rights and duties of the partners and a clear allocation of control rights with respect to the corporate bodies of the joint venture company) as opposed to complex mechanisms to *resolve* them.[47]

3. Intellectual Property

If the activities of the joint venture company require the parties to contribute or license any significant intellectual property rights to the joint venture company, they will want to ensure that they maintain a certain minimum level of control over such rights in connection with the ongoing business of the joint venture company, but

37 See also Gericke/Dalla Torre (FN 20), 56, Knobloch (FN 33) FN 119, and Oertle (FN 2), 78.
38 See Vogt/Watter (FN 4), 26.
39 See Knobloch (FN 33), FN 135.
40 See Tschäni (FN 27), 66.
41 See also Tschäni/Diem/Wolf (FN 11), 328.
42 Tender regulations may provide that the partners of a joint venture bidding for a project may not leave the joint venture, or reduce their participation below a certain minimum level, during the project period, or at least during a first phase of the project, which might – in the context of infrastructure projects – well exceed ten years. As a consequence, any put/call arrangements aimed at forcing an exit of any partner (in case of a deadlock or material breach) will not take effect during such period (or at least be subject to the consent of the customer/counterparty of the joint venture in case of an exercise of any put/call option).
43 It will, of course, often be difficult to calculate such damages incurred by the joint venture company and to prove a causal link between the unilateral decision and the damages.
44 Gericke/Dalla Torre (FN 20), 63.
45 See also Gericke/Dalla Torre (FN 20), 54.
46 See also Gericke/Dalla Torre (FN 20), 54.
47 See also Tschäni/Diem/Wolf (FN 11), 328 et seq.

in particular also in an exit scenario. Further, it will be important for such parties to ensure that they own or at least control any intellectual property rights newly developed by the joint venture company on the basis of intellectual property rights originally contributed by them. If material intellectual property is contributed to, or developed by, the joint venture company, the joint venture agreement will have to contain provisions governing the ownership and the rights to use such intellectual property during the term of the joint venture, and in particular upon its termination. Typically, the party contributing the background intellectual property that is the basis for further developments of the joint venture company, will want to ensure that it is solely entitled to the newly developed intellectual property rights upon termination; often, the joint venture agreement will state that the joint venture company has the right to be granted a license in any intellectual property rights of the (former) joint venture partners that it requires to maintain its business for a certain period of time, in particular to the extent such intellectual property rights are required to perform any contracts with customers that the joint venture company has entered into prior to the termination of the joint venture.[48] Depending on the specific features of an intellectual property license, it may have effects on the parties that are similar to a non-competition undertaking. While non-compete clauses – as long as they are limited to products and territories in which the joint venture company is active – are usually considered permissible during the term of the joint venture,[49] post-contractual non-competition clauses are subject to tighter scrutiny under antitrust law and need to be carefully reviewed with regard to scope and duration.[50]

VI. Minority in a Joint Venture: Selected Key Legal Issues

The following is a selection of key issues with legal implications that can arise in transactions where one partner has a clear minority role in the joint venture of two partners, i.e. a participation in the capital and voting rights of 40 % or lower.

1. Influence of Consolidation Requirements

When a minority shareholder in a joint venture company seeks to include significant minority protection rights in the joint venture agreement, in particular in the form of veto rights for certain matters that might have a significant financial impact on the joint venture company (such as the business plan, capital increases, entering of new markets or the development of new products, or the entering into of transactions exceeding a certain monetary threshold), the majority shareholder will often argue that it is limited in granting such minority protection rights in order to avoid losing its ability to consolidate the joint venture company in its books and accounts.[51]

The consolidation requirements under IFRS and Swiss GAAP FER relevant in a joint venture context are largely similar. In a nutshell, both standards provide that an investor must consolidate a joint venture if it controls the joint venture entity, i.e. if it has the ability to direct the significant activities of the joint venture entity, in particular to affect its returns from the investment.[52] No consolidation is required/permitted if there is joint control (i.e. the contractually agreed sharing of control, which exists only when material decisions require the unanimous consent of the parties sharing control).[53] Joint control requires the unanimous consent of *all* of the venturers over *all* significant decisions. While there are some differences between the relevant rules of IFRS and US GAAP, the principles set forth above are in our experience generally comparable to those under US GAAP.

There is significant judgment required in the application of the accounting standards to joint ventures. Nevertheless, the accounting standards and the involved external auditors of the majority shareholder in a joint venture usually are flexible enough to allow a consolidation of the joint venture company by the majority shareholder despite significant protection rights of the minority shareholder, in particular in the form of veto rights regarding material decisions on shareholders or board level of the joint venture company.

A joint venture partner may have control (in terms of the applicable accounting rules) over the joint venture company even with less than a majority of the voting rights

48 See Oertle (FN 2), 198 et seq.

49 Commission Notice on restrictions directly related and necessary to concentrations (2005/C 56/03), N 42 et seq.

50 See for example the press releases from the European Commission with regard to Siemens – Avrea, IP/12/618 and IP/12/243.

51 To ensure its ability to consolidate the joint venture company, the majority shareholder may seek contractual protections in the joint venture agreement, *e.g.*, an acknowledgment of the minority shareholder that the majority shareholder must be in a position to consolidate the joint venture company in its accounts, and an undertaking of the minority shareholder to negotiate in good faith any amendments to the provisions of the joint venture agreement if and to the extent required due to changes in the applicable accounting standards (or their interpretation) following the entering into force of the joint venture agreement to maintain such consolidation (typically with the proviso that any amendments shall be kept to the absolute minimum required and that the fundamental governance principles of the joint venture agreement shall in any case be maintained).

52 Against this background, discussions regularly arise if veto rights regarding dividend resolutions are requested or if the minority shareholder seeks a certain influence on future distributions by stipulating a dividend policy in the joint venture agreement.

53 The definitions of «control» and «joint control» under the applicable accounting rules and under merger control regulations are not identical.

(so-called *de facto* control). When assessing whether there is *de facto* control, one will in particular have to take into account whether the minority shareholder has significant rights arising from contractual arrangements, *e.g.* the commercial framework agreement, that give it the power to significantly affect the joint venture partners' returns from the joint venture company, or whether it has the power through so-called potential voting rights, *e.g.*, call options or rights to convert loans into equity. However, applying the concept of *de facto* control requires significant judgement of the facts and the circumstances of the specific case.

2. Ensuring Appropriate Influence on Business

The joint venture partner holding a minority position in the joint venture company will typically not be in control of the day-to-day operations of the joint venture company, but it will usually want to retain a certain minimum level of influence on strategic decisions affecting the fundamental principles of the joint venture and to a more limited extent also on the day-to-day operational aspects of the joint venture's business. This influence is typically ensured by way of stipulating reserved matters in the joint venture agreement that require the consent of the minority shareholder to be validly passed, and by granting the minority shareholder the right to send a certain number of designees to the board of directors and maybe also to the executive management of the joint venture company. To keep such board/management representation rights effective, the minority shareholder will also want to ensure that its board/management representatives receive sufficient information in advance of the meetings and have appropriate access rights to the management/employees/books of the joint venture company. Typically, the organizational regulations, which may only be amended with consent of the minority shareholders' representative(s), will provide for such rights.

Transactions requiring the approval of both joint venture partners or at least one board member designated by each partner typically include material adjustments to the business (and strategic) plan, the hiring of senior management or key employees, the entering into financing agreements or other material transactions exceeding a certain threshold, the entering into any contracts with a party to the joint venture or any of its affiliates, any expenditure exceeding a certain amount, and the sale of important business assets, the establishment of subsidiaries, or the entering of new markets or product lines.

Usually it is not considered necessary to allocate the veto matters to specific bodies on the level of the joint venture company or on the level of its subsidiaries; it is contractually sufficient to agree on a set of veto rights that require the consent of all parties irrespective of where they are being taken within the structure.[54]

3. Protection in the Context of the Exit

In particular from a minority shareholder's point of view, it is important to ensure that in case of an exit by the majority shareholder, or in case of a termination of the joint venture agreement for any reasons without an exit occurring, the minority shareholder is granted the right to exit the structure – often by way of the exercise of a put (or call) right – in order to avoid losing its minority protection rights granted under the joint venture agreement, unless the jurisdiction in which the joint venture company is incorporated allows to incorporate the minority protection rights in the articles of association or similar constitutional documents of the joint venture company, ideally without those being publicly available. In any case, the minority shareholder will want to make sure that it is never locked in a joint venture structure without having an agreement in place that provides it with protections that are not available under applicable corporate law.

The protection of the minority shareholder in connection with the exit of the controlling joint venture partner significantly depends upon its ability to preserve the value of its participation in the joint venture company. This may be achieved by stipulating put options at a favorable price, maybe even penalizing the majority shareholder for the termination of the joint venture applying a markup on the fair value of the participation prior to the exit and/or basing the valuation of the participation on the situation prior to the exit (*e.g.,* not taking into account future decreases of the earnings potential due to the exit of the majority shareholder).

VII. Takeaways

Each joint venture project is of an individual nature and, accordingly, entails its own legal risks and requires its own contractual framework. Against this background, it is difficult to identify any specific legal concepts as standard solutions for joint venture agreements. Still, this paper outlines a selection of issues and the related legal considerations that we have experienced as fundamental in joint venture projects.

Among the topics addressed we consider the cultural aspects as one of the key elements to be taken into account

[54] Gericke/Dalla Torre (FN 20), 31. See also Tschäni/Diem/Wolf (FN 11), 324, who state that the minority protections based on corporate law are less important in the joint venture context due to the specific contractual arrangements between the shareholders.

from an early stage of the negotiations. It is of crucial importance not to underestimate such cultural differences between the potential partners, not only in terms of cultural background, but also in terms of differences in corporate culture, for instance, if a globally active, stock exchange listed international group with significant M&A experience intends to enter into a joint venture with an owner-led, private company that has not been active in the M&A market for years, if at all. Avoiding cultural pitfalls requires sound instincts and a solid preparation – local management and local advisors will in many cases be key in sensitizing the «foreign» party to such cultural differences.

Another aspect with significant influence on the structuring of the legal framework of a joint venture is what we call the level of involvement and exposure by the joint venture partners vis-à-vis the joint venture company. The higher the risk that a failure of the joint venture or an underperformance by the joint venture partner might significantly affect any joint venture partner's core business, the more contractual protection such partner will require in a joint venture agreement. Similarly, the more (upfront) investments by the joint venture partners are required in connection with the setting up of the joint venture's business, the more they will focus on the long-term aspects of such joint venture, such as the regulation of potential exit scenarios, the financing of the joint venture's activities, and the allocation of newly developed intellectual property rights upon the dissolution of the partnership. The closer the relationship between the partners is intended to become, in particular regarding exclusivity and the restriction of the partners not to compete the joint venture company, the more important will it be for each partner to ensure a certain level of influence on the scope of the joint venture's activities.

Lastly, in most cases, we believe it to be important to focus the attention in the negotiation phase not only on the (main) joint venture agreement, but also on the ancillary agreements governing the relationships between the joint venture company on the one hand and the joint venture partners (and their affiliates) on the other hand following the establishment of the joint venture. Such agreements typically cover commercially sensitive topics – such as allocation of profits, (project) risks and intellectual property rights – and have a significant impact on the day-to-day operations of the joint venture. While the terms of the joint venture agreement may be rather standard in some cases, the commercial terms of ancillary agreements are very often singular and, thus, may be a source for commercial disagreements – the sooner these are tackled, the better.