

## International joint ventures | BY JOHN L. KEFFER

This article first appeared in *FinancierWorldwide's January 2010 Issue*.  
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The reasons for deciding to form a corporate entity together with another party for profit (commonly referred to as a joint venture) vary greatly, but often turn on a desire to mitigate the risk of doing business in another country. In some jurisdictions one may not have a choice as the law may require you to have a local partner. In other contexts, contemplating doing business in an unfamiliar country may drive the need for a joint venture. Finally, one may wish to direct one's business in a direction that is not at its core competency, and joining up with a more experienced partner may be prudent. Whatever the motivation, the risks of partnering with another are not insubstantial and raise various issues that one should bear in mind.

### Form and governing law

A key issue to address is the form the joint venture will take and its governing law. The term 'joint venture' is typically applied to any situation where more than one party has participated in the formation of the entity and where there is an expectation of sharing in the profits of the venture. The form that the entity takes can be various, whether it be a corporation, limited liability company or partnership, or limited partnership. What is rare, though, is that the jointly owned business is conducted in the form of a true joint venture or partnership as such entities do not offer the parties the protection from unlimited liability that corporations, limited liability companies or limited partnerships do. Another key issue is deciding under what law to form such an entity. Both the choice of entity as well as the law governing the formation will often turn on tax issues, which in turn will turn on the jurisdiction of the parties to the joint venture and the location of the business being jointly pursued.

### Ownership and governance

Ownership and governance issues are often times hotly contested issues, particularly in situations where the parties' relative strength and contributions to the joint venture are equal. A party's bargaining position will be significantly different if it merely owns, say, 10 percent of the joint venture. In the context of corporations or limited liability companies, governance issues that need to be addressed include: the role of the directors or managers and the number to be elected by each party; which issues will be decided by the directors or managers and which by the shareholders or members; and what matters will be decided by supermajority vote such that the party with the minority ownership will have a negative veto.

### Deadlocks

Closely following any discussion of supermajority vote provisions should be what occurs if the parties cannot agree on a matter that requires such a vote. One can choose to take the view that if the matter does not get the requisite vote, then the matter is not pursued. However, there are issues that may be so fundamental that to not reach agreement on them may indicate that the parties have reached the point where they should not continue in business together. These possibilities of deadlock are not uncommon and should not be ignored. Disagreements over less minor issues, such as the approval of a material contract, should probably not result in a deadlock, whereas the parties' inability to agree on the annual budget or other matters that materially affect the liquidity of the venture, should be considered for deadlock resolution. Deadlock procedures of-

ten begin with mandated negotiations, typically escalated to the parties' respective chief executive officers. Failing a negotiated settlement, provisions that can lead to one party buying out the other at a fair price are often negotiated. Sometimes the parties agree to submit deadlocked matters to arbitration although this should be considered with great caution as what are essentially business disputes do not readily lend themselves to arbitral decisions.

### Exit provisions

The manner in which one will exit the joint venture should be contemplated from the beginning and can take many forms. Transfers of one's equity interests, whether in whole or in part, should be permissible, although black out periods during which no transfers are allowed are not uncommon on the basis that the joint venture will need a period of stable ownership. Be sure to check on local laws as some countries will not enforce clauses that prohibit transfers altogether. If transfers can be effected, the non-transferring party is often accorded a right of first refusal or right to match, thus avoiding the introduction of a new party to the venture. Tag-along and drag-along provisions are also commonly seen. A tag-along permits a minority owner to benefit from a sale by the majority owner and not be left behind, and a drag-along permits the majority owner to cause a sale of the entirety of the business, which will result in a higher valuation of the equity. Finally, registration rights may be an appropriate exit mechanism, permitting the parties to cause the joint venture entity to register its equity securities on a recognised securities market and thereby achieve liquidity for the investors.

### Termination and dispute resolutions

Some joint ventures have a natural life span, such as the use of a joint venture for the construction of a commercial building, and in such instances the joint venture would come to its end upon completion of the building. However, many joint ventures are intended to have an indefinite term, but nevertheless should address instances in which they should come to an end. These include: a party's breach of its obligations with respect to the joint venture; a party's bankruptcy; and the change of control of a party. The result of a termination may be to permit the non-offending party to call on the equity ownership of the other party, perhaps at a discount to its fair market value to reflect the 'bad act'.

The manner in which disputes are to be resolved also needs to be included in the agreements governing the parties. In the context of a cross-border joint venture, it is typical for both parties to agree to submit the dispute to international arbitration. However, ensuring that an arbitral award is enforceable in the jurisdiction of the party against which enforcement is sought is critical.

Joint ventures are popular methods of doing business in cross-border situations. However, because by definition one is not undertaking the venture on one's own, total control is lost and compromises must be made. A well crafted joint venture agreement that draws on experience can help mitigate the risks and lay the foundation for a successful partnership. ■

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