United States

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Introduction

In General

Forming a "joint venture" between one or more uncontrolled companies is one of the most frequent means of conducting international business. This form is most commonly used as a way to share the risks associated with a new enterprise and take advantage of the relative skills or assets of the venture partners.[1]

Joint ventures can take many forms. Domestic joint ventures occur between two or more partners or parties from the same country conducting business in the same country. If a joint venture is to be conducted in the United States, the most basic decision to be made in structuring a domestic joint venture is whether the joint venture entity should be structured as a partnership or corporation for United States tax purposes.[2]

If the joint venture partner is a foreign entity joining with a United States company in a United States venture, the choice is between operating in the United States through a domestic branch of a foreign corporation or as a United States subsidiary.

International joint ventures involve joint venture partners from different countries who may conduct the venture in one of the partner countries, in a third country, or in multiple countries. Common catalysts of why a business may want to form a joint venture with an unaffiliated business include the need to supplement current operational capabilities in a specific market or markets; the desire for market access in an area of the world where the non-foreign partner has no or limited access; capital and/or technology; risk sharing and the access to a favorable financial climate; the impact of operating de-consolidated business during its

1 Lainoff, "United States Taxation of Foreign Joint Ventures", 41 *Tax. L. Rev*. 101 (1991); West, "International Joint Venture: Selected Practical Considerations, 2 *J. Tax'n Global Transactions* 27 (2003).

2 Lainoff, "United States Taxation of Foreign Joint Ventures", 41 *Tax. L. Rev*. 101 (1991); West, "International Joint Venture: Selected Practical Considerations, 2 *J. Tax'n Global Transactions* 27 (2003).

startup phase; or the need to move beyond a contractual relationship with a particular business partner to a stage of operational integration.[3]

When a United States-based group decides to participate in a foreign-based joint venture, a number of important issues having consequences should be addressed including, but not limited to, general planning considerations; determining commercial objectives; development of new markets for existing products of technologies; developments of new products or technologies; exploitation of business strengths between joint venture partners; determining local partner requirements; the intended duration of joint venture (single transaction or short-term relationship versus continuing business or indefinite relationship); general funding requirements; analyzing factors influencing the choice of joint venture vehicle; restrictions imposed by local law (e.g. restrictions on ownership of property or conduct of business by foreign persons that mandate the use of locally formed corporation); the forms of joint venture vehicle permitted under local law (e.g. corporation, partnership, limited-liability company or equivalent, trust, contractual arrangement); shareholder rights and related issues; potential tax liability of the joint venture or joint venture partners as a result of the joint venture; available "exit strategies"; establishment and maintenance costs; determining respective economic contributions and interests of the parties; funding requirements and pay-in schedule (how much required and when); allocation of costs among parties; and a range of other considerations.[4]

This chapter is not intended to be a comprehensive, full-scope treatment of all aspects of international joint ventures.[5] Instead, this chapter intends to address some of the threshold issues and considerations that flow from the formation of international joint ventures, with a focus on the United States perspective.

Reasons Underlying Joint Venture Relationships

In General

A joint venture carries with it a number of advantages and disadvantages. A joint venture can provide a party with access to resources and skills that are unavailable to it at any reasonable cost. However, a joint venture also can be risky because of the reliance that must be placed on the ability and willingness of the other party to perform its obligations during the term of the joint venture agreement.[6] The success of a joint venture depends on both parties fulfilling

3 West, "International Joint Venture: Selected Practical Considerations", 2 *J. Tax'n Global Transactions* 27 (2003), at p. 28.

4 Lowell and Martin, *United States International Taxation: Agreements, Checklists, and Commentary* (2011), section 4.01, at pp. 1–4.

5 This chapter does not constitute legal advice, and any person seeking legal guidance regarding joint ventures, international or domestic, should consult with an attorney regarding his/her/its specific questions that relate to their specific entity or joint venture questions.

6 Gutterman and Brown, *Going Global: A Guide to Building International Business*, 2014, Chapter 31, section 31.7.

their respective roles in the venture. Thus, before entering such a relationship, a party should understand the range of reasons for and against entering into a joint venture relationship:

Sharing Financial Burden

A party may not have sufficient financial resources to take on a particular project by itself and, accordingly, may seek a partner to share the financial burdens and other risks of the project.

Accelerating Market Penetration

A party may seek a joint venture with a foreign partner to conduct business in a foreign market as a means of accelerating the pace of its market penetration in the foreign market.

Here, the non-foreign party would look to the foreign party to provide the requisite knowledge of local tastes, customs, government relations, market behavior, and advertising, if needed. A joint venture also may be required for a non-foreign party entering a foreign market to satisfy foreign country rules requiring local participation and/or ownership since some countries prohibit foreign ownership in certain industries.

Obtaining Technical Resources and Skills

A party may want to gain access to the technical resources and skills of another party. A joint venture bringing together managers and scientists from each party may facilitate the rapid exchange of such information regarding existing and new technologies.

Direct Management of Research, Manufacturing, or Distribution

A party may choose a joint venture structure, rather than a network of contractual relationships, to ensure that it is in a position to directly manage research work, manufacturing, distribution, or technology.

Decrease Manufacturing Costs

A party may use a joint venture to decrease the current costs associated with the manufacture of its products in more expensive labor markets, while retaining some control over the quality of the process and the technology used in the course of completing the manufacturing activities.[7]

7 Gutterman and Brown, *Going Global: A Guide to Building International Business*, 2014, Chapter 31, section 31.7.

Identifying and Evaluating Joint Venture Risks and Due Diligence

Partner Risks

In General

Devoting substantial and critical time and effort to locating appropriate candidates for a joint venture is a paramount step in the joint venture process. [8] While an existing relationship with a current supplier, distributor, or customer may evolve into a desire to form a joint venture relationship, in instances where there is no prior familiarity with the prospective partner, information about potential joint venture candidates can be solicited from a variety of sources.

These sources include trade associations, the chamber of commerce, investment and commercial bankers, lawyers and accountants and independent consultants, and published reports filed with the United States Securities and Exchange Commission and with similar regulatory agencies in other countries. Government organizations in many countries (e.g., Ministry of Commerce, Ministry of Trade and Industry) often serve as good sources for foreign investment and joint venture transaction information.

There is no single formula or quantitative analysis available for choosing the right joint venture partner, but narrowing the list of qualified candidates may be based on a number of factors including: their financial resources, reputation, skill-set, expertise in technology, market access, labor pool, political access, or other qualities. However, once appropriate candidates are identified, an extensive due diligence investigation should be conducted to determine whether the prospective venture partner would provide the party seeking the joint venture partner with the best opportunity to meet its business objectives.

By its very nature, a joint venture requires two or more parties or groups to partially integrate their skills, attitudes, biases, and experiences of the organizations of each of the partners' capital, as well as many of the persons within them. Among the factors to be considered when choosing a joint venture partner are:

- Compatibility — The compatibility of the prospective partner with the company seeking the partner in areas such as the level of commitment to the joint venture, the size and structure of the prospective partner, and its underlying national and corporate cultures is paramount to a successful joint venture. Under the best of circumstances, the parties will have had a prior working relationship with one another prior to forming a venture, and will have some familiarity with each other's strengths and weaknesses. In more challenging circumstances, the prospective partner will be identified through a search process and due diligence evaluation. In these instances, identifying compatibility may be a slower process and may meet with mixed success until the parties establish a working synergy based on their experience together.

8 Gutterman and Brown, *Going Global: A Guide to Building International Business* (2014), chapter 31, section 31.7.

- Functional Skills and Resources — The functional skills and resources of the potential partner, as they relate to the objectives of the joint venture, must complement those of the party seeking the partner. If the potential partner adds value to the purposes of the joint venture, that fact should be more important than a potential partner’s areas of weakness that may not otherwise be relevant to the objectives and requirements of the joint venture.
- Managerial Resources — The potential partner should have the managerial resources required to provide all needed assistance to the joint venture, specifically in those areas in which the partner will have primary functional responsibilities, whether it be providing labor, management, or capital to the venture.
- Facilities and Administrative Support — The potential partner may need to provide facilities and administrative support for a portion of the joint venture’s activities such as office space and clerical and administrative assistance, particularly when the joint venture is based in the potential foreign partner’s home country.
- Governmental Relations — If the joint venture requires in-country assistance, coordination, official approvals, and licenses, the foreign partner’s ability to assist with and facilitate those governmental relations can be extremely important. For example, in a number of foreign countries, the government exercises actual or de facto business, industry, and administrative authority over local activities, agencies, and departments, and no venture can be successful without such government approvals and support.
- Financial Resources — In addition to providing any functional activities that it will be called upon to undertake for the joint venture, the potential partner should have sufficient financial resources to support their obligations to the joint venture; otherwise, a venture partner who is the primary capital investor may find itself over-budget and over-invested in the venture in a foreign country with a foreign partner who can benefit from, but cannot contribute financially to, the venture. The reverse is true when the foreign-based capital venture partner promises funding at a certain level to the joint venture and the local host country partner makes financial commitments in the host country based on anticipated funding of its foreign capital partner that does not materialize. Additionally, the joint venture may not be supportable if the financial funding goals are not reached. Underestimating the overall financial needs of a venture is the death knell of many joint ventures.
- Reputation in Market — The potential parties should have a solid reputation in the market in which the joint venture will operate. A good reputation of both joint venture parties will facilitate the success of the venture. This factor is particularly important if the venture’s success relies, in part, on the foreign partner having or building a customer base to promote the venture’s products in the foreign partner’s country. Once a prospective list of potential joint venture partners is identified, information on all of the above factors, as well as the specific skills and resources to be contributed by each prospective

partner to the joint venture and the potential parties should be reviewed carefully during the formal due diligence investigation. During this period, the initial partner should focus on the overall strategic objectives of the prospective partner in entering into the joint venture, including paying particular attention to the possibility that the prospective partner may ultimately use the knowledge obtained in the course of the joint venture to compete against its joint venture partner.

Venture Risks

In General

In considering an international joint venture, especially in an emerging market country, the joint venture partners should consider a number of risks in assessing the type of venture to pursue and the form of the entity to be employed.[9]

Political Risks

A party seeking a joint venture should consider the stability of the government in the country where the venture is to be performed. Is the local government a mature democracy, a kingdom, an emerging democracy, or a current or former communist or socialist state? Do they have representative or prohibited political parties? Does the military have control of or strong influence over the government? What is the country's history of nationalizing foreign investments? Is there freedom of the press and assembly? Have there been recent public disturbances, labor strikes, government shutdowns, or riots that could impair the ability to successfully analyze and/or control certain risks to the joint venture?

Is corruption in the foreign government of the venture country common enough to be a constant hurdle for the joint venture? Will the local government or government officials threaten the viability of the joint venture if bribes are not paid? Will the venture need government support to succeed? At what price will the government or local government support be provided? Can a United States venture partner operate in this environment without running afoul of the Foreign Corrupt Practices Act (FCPA). Among the ways these political risks can be reduced and be addressed are:

- If future regulatory needs are anticipated, build them into agreements early before the project's expected life span;
- Build in as much certainty as possible regarding foreign country government regulatory matters;
- Build in anticipated regulatory needs early before the project's usefulness is obsolete; to discourage venture partners, managers, and vendors from engaging in bribes and kick-back schemes;
- Adopt strict prohibitions in the joint venture and operating agreements;

9 Baker & McKenzie, L.L.P., *International Joint Ventures Handbook* (2013).

- Avoid becoming involved with politically-connected partners whose current fortunes may change with a new government administration;
- Early on, involve international institutions in the venture's life to obtain political cover from local government interference and to obtain outside oversight by more neutral institutions;
- Involve suppliers, subcontractors, and other local participants in political risks so they also have vested interests in assisting the venture with government relations;
- Adopt strict guidelines for dealing with suppliers and vendors and subcontractors whose conduct could expose the joint venture to FCPA violations; and
- Avoid making secret side deals with in-country political players that may later be exposed and exploited when those political players fall out of favor.

Venture Maturity Risks

While the risk of expropriation or nationalization of joint venture assets or opportunities in the country of operation or formation is typically viewed as a political risk triggered by a change in government or political climate, effective expropriation may occur in other ways.[10] In the early years of a venture with the infusion of capital, technology, plant, or other matters, the benefits to local government are clear.

However, in the later years of a venture, the non-resident partners' contribution to the venture may be less obvious to the local or national government and their return on recent investment viewed as high, and the permanent assets of the joint venture on the ground in the foreign country viewed by the local government as attractive.

In these cases, local competitors may put pressure on local governments to start reducing advantages for the non-resident joint venturer or for the local joint venture. Such risks may be minimized in several ways, such as choosing projects that sell wholesale rather than retail; building into the agreement an ability to increase capacity if local demand outstrips projections; investigating whether a management and operating agreement may be an equally effective means of meeting venture objectives since they are less susceptible to nationalization and expropriation than actual ownership; and consider obtaining appropriate forms of public or private insurance before committing capital and resources to the project in question.[11] Additionally, the joint venture parties may want to have agreements with the local host country government that ensures increasing local employment over time, as a means to reduce potential government interference in the joint venture.

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10 Lowell and Martin, *United States International Taxation: Agreements, Checklists, and Commentary* (2015).

11 Lowell and Martin, *United States International Taxation: Agreements, Checklists, and Commentary* (2015).

Currency Risks

Is the venture required by law to conduct transactions in the local currency? If so, is the local currency convertible? Is the local currency stable? Do exchange control currency laws of the jurisdiction restrict the payment of dividends or the movement of capital out of the country?

Do currency fluctuation clauses need to be negotiated with suppliers and customers? Does the joint venture entity form restrict the payment of dividends? Are there any ways to overcome the restrictions through hedging of risks with derivatives, insurance, or obtaining exemptions as a condition to investment?

Local Business Risks

Is the local economy stable? Will manufacturing costs, including labor costs, remain stable or increase dramatically? What is the strength of labor unions in the country where the venture will be performed? Are there existing or potential local competitors to whom the government will provide special privileges that will create an uneven playing field to the detriment of the joint venture? Are there any ways to address these risks, such as working with a politically-connected local partner or working with the labor unions or political leaders to obtain fairness in investment and local support?

Legal Risks

Does the targeted country respect the Rule of Law? Do government officials, including judges, have significant discretion with respect to interpretation and enforcement of laws? What are the local country's labor laws? In some Latin American countries, for example, such as in Mexico, under its traditions and jurisprudential system, employment is viewed almost as a constitutional right, making termination of non-productive employees very difficult and potentially very costly for joint venture employers. Is there corruption in the judicial system?

Can the risks be offset by choosing a dispute resolution forum that is neutral or outside the influence of the local country? Is there a reliable appellate and judicial system for seeking relief from unfair, corrupt, or poor trial judges? Are the supreme court judges in the venture country appointed or elected and are they truly independent of political institutions and departments? Does the election or appointment system for judges ensure a fair judicial system? Does the joint venture agreement need to incorporate an arbitration clause designating a neutral arbitral tribunal, such as the ICC courts, the London Court of Arbitration, or the American Arbitration Association's International Centre for Dispute Resolution (ICDR) so that disputes are not resolved by the local laws of one of the joint venture partners?

Enforceability of Contractual Safeguards and Joint Venture Documents

Is the choice of law provision valid and enforceable? The enforceability of the choice of law and the forum selection clauses may or may not be decided by the venture parties' chosen arbitral tribunal. Those legal issues may be decided based on the scope of responsibilities the parties assign to the chosen arbitral tribunal. If the arbitral tribunal is not designated to decide these preliminary issues, the interpretation of such clauses may be made under one or the other parties' local laws and courts and the other joint venture party may be disadvantaged. Is an injunction order to enforce a contractual right available?

Can the venture partners obtain relief from the local courts in the event of a violation? Are judgments in the local courts predictable and/or enforceable once a judgment is obtained? Is there an identifiable appeals process? Is the local country a party to international treaties for an enforcement of foreign money judgments and arbitral awards such as, for example ICSID or NAFTA?

Selection of Entity as Risk

What are the available forms for the joint venture — such as corporation, limited-liability company, B.V. (*Besloten vennootschap)*, partnership, N.V. (*Naamloze Vennootschap*, which is the equivalent of a public company), or S.A.? Which of the types of entities typically used for a joint venture is most common in the country where the joint venture will be performed?

If the form of a joint venture is a corporation formed under the laws of the venture country and the joint venture agreement contains a different choice of law, do the corporations laws of the country of incorporation mandate the application of its laws or does the joint venture choice of law control? Does the local law require known capital contribution and/or contributions in kind or do they require only cash contributions? Can the corporate form selected by the venture partners pay dividends at any time or are there timing restrictions on the payment of dividends?

Can the distributions be made out of capital or only out of profits? Are interests in the particular kind of entity assignable or sellable if the joint venture partner must exit or dilute? Does local law require foreign investment in a specific sector of the economy by certain kinds of entities? Are there restrictions on certain types of local companies investing in certain activities?

What is the local market's perception of the type of entity? What are the transactional costs involved in using such an entity? How should income be characterized? Are there any host country grants and incentives available based on which type of entity is selected? What labor laws impact any mandatory benefits for employees and may add unanticipated costs to the venture?

What United States and foreign tax laws impact choice of entity? Is there an exit strategy from the local country if the market becomes financially or politically unfavorable? Does a member have any right to withdraw and its interests be redeemed by the joint venture through a buy/sell agreement? Is it advisable to set up an offshore entity to hold legal title to joint venture assets so the local partner in the country of operation of the joint venture cannot simply seize the assets of the joint venture and simply have their liability adjudicated under their local laws?

Can members dissolve the venture company in case of a deadlock and is an agreement concerning such dissolution by a member enforceable? Does the local entity provide limited liability to its equity owners from third-party creditors and, if not, what is the exposure to the local owners and can it be predicted?

Structuring Joint Venture and Choice of Legal Form

In General

The choice of the form of legal entity to conduct the actual joint venture operations is primarily a local law issue and is driven by a combination of the foreign investment laws, business considerations concerning the rights and duties of the joint venturers, and the local and United States tax implications of the structure.[12]

A joint venture formed to conduct business outside of the United States may be conducted through a foreign corporation. However, the joint venture agreement is typically separate from the incorporation documents.[13] The joint venture also may be conducted as a partnership. In a partnership-based venture, the terms of the agreement between the venturers can be spelled out in a separate joint venture agreement or they may be included in the partnership agreement. Similarly, the joint venture vehicle can be a foreign limited-liability company.

Regardless of the corporate form chosen by the venture partners, automatic provisions of local law, including default provisions when an item is not specifically addressed in a joint venture agreement or operating agreement, should be carefully reviewed prior to execution. It is particularly important to review any conflicts between provisions of the joint venture agreement and local corporate or partnership or limited-liability company law where the joint venture contemplates setting up companies under local law.

Depending on the nature of the relationship between the parties, there also are other means of conducting joint venture arrangements, including joint ventures relating to research and development that produces intangible property formed as a cost-sharing arrangement or as a patent pooling arrangement.[14] A lengthy discussion of the advantages and disadvantages of the form of legal entity is beyond the scope of this chapter.

The typical United States entity structure of a corporation, limited-liability company, or partnership has counterpart entities in many other jurisdictions.

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12 Lowell and Martin, *United States International Taxation: Agreements, Checklists, and Commentary* (2015), at pp. 1–4.

13 Lowell and Martin, *United States International Taxation: Agreements, Checklists, and Commentary* (2015), at pp. 1–4.

14 Lowell and Martin, *United States International Taxation: Agreements, Checklists, and Commentary* (2015), at pp. 1–4.

However, the laws regarding the scope, duties, obligations, and limitations on these various corporate entities will vary from country to country. Thus, joint venture parties should not assume that the corporate entity similar to a corporation in the United States (for example, an S.A..) will have all the same attributes, protections, and prohibitions that its corresponding or comparable United States entity will have under United States law.

Thus, a United States joint venture seeking to do business in a foreign country should retain local counsel to advise them and walk them through specific differences in the chosen corporate form and the goals, concerns, or protections needed by the joint venture parties. The general advantages of the corporation and limited-liability company structure and their equivalent type of foreign entities is that under normal circumstances shareholders will be shielded from personal liability for corporate debt.

Partnership Tax Issues

While the scope of this article is limited as to tax issues and international tax coverage, historically, prior to the Taxpayer Relief Act of 1997, the structuring of a joint venture as a partnership generally would have been a United States partnership, not a foreign partnership.[15] Otherwise, foreign partnerships would have been subject to section 1491 excise tax on any appreciation of United States operating assets (other than cash) transferred to the foreign partnership.[16] Absent the application of section 367 principles, the section 1491 excise tax would have been imposed.

Under section 367, United States trade or business assets cannot be transferred to a foreign corporation without recognition of gain. Consequently, electing the application of section 367 principles would have resulted in the recognition of gain with a corresponding basis step-up in asset basis, whereas not electing the application of section 367 principles would have resulted in the application of the section 1491 35 percent excise tax without a basis step-up in the transferred assets. Because section 1491 as it applies to transfers to partnerships was repealed by the 1997 Act,[17] the partnership may be either a United States or foreign partnership.

Faced with a United States company's desire to use a partnership as a joint venture vehicle, a foreign party's next decision is whether the joint venture should be an eligible hybrid entity that is treated as a corporation for foreign tax purposes but is treated as a partnership for United States tax purposes pursuant

15 Lowell and Martin, *United States International Taxation: Agreements, Checklists, and Commentary* (2015), at pp. 1–4.

16 Lowell and Martin, *United States International Taxation: Agreements, Checklists, and Commentary* (2015), at pp. 1–4.

17 Lowell and Martin, *United States International Taxation: Agreements, Checklists, and Commentary* (2015), at pp. 1–4.

to a "check-the-box" election. The principal reason for considering the use of a hybrid entity would be to achieve deferral from a foreign tax perspective.

In most countries, however, any deferral benefit would be of limited value if distributions made by the joint venture were taxable to a foreign-owned corporation, because deferral would continue only so long as the foreign-owned corporation is willing to leave its joint venture profits invested in the joint venture with the United States company. If, instead, the foreign company's country of residence exempts dividends received from a foreign joint venture entity, either pursuant to its internal law or pursuant to the double taxation provisions of an income tax treaty (e.g. Canada generally), the use of a United States or third-country hybrid entity may be beneficial.[18]

The considerations relevant to the foreign party in a United States joint venture differ if the foreign party is an individual or a closely held group. Depending upon the application of United States estate tax treaties, an interest in a United States or foreign partnership that holds United States operating assets may be includible in the gross estate of a nonresident alien individual, and an interest in a United States corporate joint venture will be includible in his or her gross estate.

From that perspective, a nonresident alien individual generally would not wish to own a United States joint venture other than through a foreign corporation. Using a foreign corporation to avoid United States estate tax, however, involves a cost in the form of a branch tax (if a foreign corporation holds a partnership interest) or United States withholding tax (if a foreign corporation holds a partnership interest through a wholly owned United States subsidiary).[19]

Management and Control of Joint Venture – Board of Directors

Under United States law of corporations, the board of directors,[20] typically elected by the shareholders, will be responsible for the overall direction and management of the corporation.[21] The procedures for selection of the board of directors should be set forth in the charter documents of the joint venture (e.g. certificate of incorporation and bylaws) or in the other agreements between the parties that describe their voting rights. In smaller corporations, the directors also tend to be major shareholders since the board is elected by the shareholders.

18 Dolan, *et al*., *United States Taxation of International Mergers, Acquisition and Joint Ventures,* Current through 2015.

19 Dolan, *et al*., *United States Taxation of International Mergers, Acquisition and Joint Ventures,* Current through 2015. at paragraph 6.02[2] "Multiple United States Joint Ventures with Different Partners".

20 Gutterman and Brown, *Going Global: A Guide to Building International Business,* (2014), chapter 31, section 31.19.

21 Egan, "Fiduciary Duties of Corporate Directors and Officers in Texas", *Texas Journal of Business Law,* Spring 2009; *C.A., Inc. v. AFSCME Employees Pension Plan,* 953 A.2d 227 (Del., 2008); *Gearhardt Industries, Inc. v. Smith International*, 741 F.2d 707 (5th Cir. 1984).

In larger corporations, particularly multi-national corporations, the board is recommended by various committees and members may be appointed or a slate of directors voted on by shareholders at annual or special shareholder meetings. If a limited-liability company (L.L.C.) form is chosen, the controlling officers are either members in a member-managed L.L.C or a managing member in a manager-managed L.L.C. In either form of L.L.C., the members may still elect a board of directors and simply delegate executive management authority to a manager or managing member or director.

Among the issues which should be considered in setting up a board of directors is the actual size and composition of the board; the procedures for allocating control of the board in those cases when the parties do not choose equal representation; selection of the chairman of the board of directors; determining the role of the board of directors in relation to the officers, on the one hand, and the shareholders, or members, on the other hand; and the circumstances under which control of the board may shift to one of the parties.

The composition of the joint venture board of directors is largely dictated by the role that it will play in the day-to-day operations of the enterprise. In some cases, the board of directors will serve a largely ceremonial purpose, and active daily management will be vested in the officers and managers of the joint venture. However, if the parties anticipate that the board of directors will take an active role in the management of the joint venture, it is likely that its membership will include one or more of the senior officers and operational managers to be selected by the joint venture parties.

Each party should make an effort to ensure that its designees to the board of directors have specific experience in either the functional or the geographic areas in which the joint venture will be operating. As the venture develops, the composition of the board of directors should reflect its changing business activities. A shift in emphasis of the joint venture from a development stage to the implementation and marketing stage may create a need for different board members.

Sometimes, one of the parties, themselves a separate operating company, also may reorganize its own internal structure, thereby causing responsibility for a given product or function to change. In those cases, it is important to ensure that the directors selected by that party continue to support and be able to articulate the needs of the joint venture within the new organization.

With respect to control of the board of directors, for example, one of the parties may be given the right to designate the number of directors necessary to control the board of directors, such as the right to designate three members of a five-member board of directors. For example, if a venture party contributes the largest percentage of cash or assets to the venture, that party may merit control of the board of directors. In other instances, one of the parties may be given the right to control the board of directors, subject to the prohibition that certain actions cannot be taken without the consent of all of the directors,[22] or the parties may pre-agree to shift control at some designated benchmark point in the future.

For example, a party who is contributing "sweat equity", marketing, distribution, and building the customer base expertise, may earn a larger percentage interest in the management and control of the venture as time goes from a largely passive equity investor in the venture. Finally, the parties may wish to provide for one or more mutually selected independent directors and implement a voting procedure that vests final decision-making authority in the independent directors in those situations where the parties are unable to reach a consensus.

Change in Control upon Maturation

The control structure for the joint venture entity can be implemented in any number of ways. In a corporation form, for example, when the corporation has a single class of outstanding shares of capital stock, the parties will agree by contract to vote their shares for the designees of the other party, and vacancies will be filled by the party having the right to select the nominee for the specific position.

Alternatively, when each party has been issued a separate class of capital stock, the charter documents may provide for the election of a designated number of directors by the holders of each class of stock. As the venture matures, the changing needs of the joint venture may require that the parties consider providing a mechanism to shift effective control of the board of directors from one party to the other party. After the passage of a specified period of time or upon the occurrence of one of several events to be agreed on by the parties, such as achieving certain financial benchmarks, such "vote-switch" procedures would allow one of the parties to elect a majority of the board of directors, without altering the respective financial interests of the parties in the profits of the venture.

Depending on the circumstances, a change in control of the board of directors may be accompanied by corresponding changes in the scope of authority provided to the body in the charter documents of the joint venture. A change or assumption of control of the board of directors upon a certain specified date need not be punitive and may simply recognize the development and maturation of the joint venture and its activities.[23]

22 Many commentators consider this the most appropriate structure for the joint venture form, since it vests in one of the parties the ability to initiate actions and manage the joint venture while preserving appropriate protections for the non-controlling party.

23 For example, if the business plan contemplates an initial period of joint development activities, it would seem logical that each of the parties should share in the control of the joint venture during that period, particularly if one of the objectives of the enterprise is to ensure appropriate transfer of technology. However, upon completion of the development stage, the activities of the venture will shift toward sales and distribution; and, at that time, it may be appropriate for the party with the specific distribution capabilities to assume responsibility for the day-to-day operations of the joint venture.

Change in Control upon Failure to Reach Objectives

In addition to the primary business activities of the joint venture, it is common to see the parties provide for a shift in control if the joint venture fails to achieve certain pre-agreed performance objectives. For example, a party engaging in the joint venture to improve distribution of its existing products in the local foreign market may seek more control of the enterprise if the level of sales does not meet certain specified minimum revenue figures.

Once control has been achieved, the party may initiate appropriate changes in local personnel, modify the business and marketing plans of the enterprise, or even suggest that the local venture party cannot provide the anticipated amount of distribution support required to make the venture successful.

A change in control also may be dictated by the occurrence of one or more specified external events, such as the inability of the joint venture to meet its obligations to third-party vendors, the inability of one of the joint venturers to fund the joint venture at the levels contemplated or promised, the onset of bankruptcy or similar proceedings, or to preserve the value of the assets of the joint venture. Change in control also may be needed if a party breaches its contractual obligations to the joint venture and/or to the other party, or otherwise harms the joint venture.

A change in party control may give rise to a need to change the “control model” whether the new Board or Manager reverts to the existing model or a new model is implemented. The ease of accomplishing this transition depends, in large part, on the type of default and the degree of authority being exercised by the parties with respect to essential functions of the enterprise. Moreover, many of the events that trigger a shift in control may be so serious that it may be appropriate for the parties to restructure, or even terminate, the activities of the joint venture.

Management and Control of Joint Venture

The management and control structure of the joint venture is one of the most important matters to be negotiated between the parties.[24] If the choice is made to utilize the corporate form of business entity, the parties must consider various issues involving the composition of the board of directors, the election of the board of directors, the selection of the emerging officers and key managers, the issues that will require a full vote of the board of directors, the respective voting rights of each of the parties and the matters on which each will be allowed to vote, and the specific duties of the board of directors, the officers, and any committees created by the parties to manage one or more of the business functions of the enterprise.

24 Gutterman and Brown, *Going Global: A Guide to Building International Business*, (2014), chapter 31, section 31.17.

Board of Directors' Decisions

The parties should decide whether and how to designate one or more representatives to the joint venture to act as members of the board of directors, or as officers of the joint venture. In addition, each of the parties should have voting rights on matters of importance to the joint venture. While oversight authority should remain in the board of directors, the joint venture parties may decide to hire or delegate someone to assume day-to-day control over material aspects of the operations of the joint venture.

The actual participants in a joint venture may be business units of their respective companies, such as a division or a wholly-owned subsidiary, or they may be a separate entity created solely for the purpose of managing and operating the joint venture. The board of directors, which will include the managing director and representatives from each of the parties, will have the role and responsibility to review the operational activities, approve and monitor the strategic plans and budgets, approve major transactions relating to the joint venture, and provide advice and consent on important personnel decisions.

In addition to choosing the board of directors, the most important decision faced by the joint venture is the selection of the manager of the joint venture, who may be referred to as the "managing director" or "president". It is common to provide from the outset a rotation for the managing directors' position, based on objective performance measurements of the business of the joint venture. In some cases, the local partner may have the right to designate the initial general manager, while the foreign party would have the right to interview and approve proposed managing director candidates.

Once the foreign party has had an opportunity to gather information and experience in the new market, and the joint venture has grown to a specified size in terms of revenues and/or employees, the foreign party should have a right of increased involvement in designating the general manager.[25]

Another possibility is to plan on development of independent leadership for the venture. In this scenario, the general manager or managing director position will be awarded to qualified candidates that are mutually agreed upon by the parties, but who have no prior relationship with either of the parties.

Balanced leadership also may be achieved by allowing one party to designate the general manager while the other party has the right to select the chair of the board of directors. Depending on the prior relationship between the joint venturers, their familiarity and comfort level in delegating various aspects of the joint venture to each other, and the success or failure of the joint venture in meeting its objectives, different management and operational models may be appropriate.

25 Gutterman and Brown, *Going Global: A Guide to Building International Business,* (2014), chapter 31, section 31.17.

Management Models

In General

There are three basic governance structures or models from which the joint venture parties can choose when deciding how to manage the business operations of a joint venture: operator, shared, and autonomous.

Operator Model

The operator model of management is often used when one party has little experience in the joint venture market.[26] When the "operator model" is selected, the management responsibilities for the joint venture are assigned to one of the venture parties. However, the assignment of management responsibilities does not necessarily flow from ownership interests.

A majority interest owner may or may not be the operator, particularly if the majority owner is a passive investor with no real operational expertise in the function of the venture. In fact, a minority owner in the venture may be designated as the operator when it has more experience in the project of the joint venture than the majority owner, or when the majority owner is a partner who does not reside in the location of the joint venture.

The operator will be responsible for management of the day-to-day activities of the joint venture, including coordination between business units and establishment and operation of management systems and processes. The operator will typically have the right to designate the managing director and persons who will serve as managers of the main business units and functions within the joint venture. Under this model, the decisions made regarding the operations of the joint venture will be primarily based on ongoing communications between the venture managers and their colleagues who work full-time in their separate organization of the operating party.

The operator model may be most appropriate when one of the parties is new to the market in which the joint venture will be operating and the other party to the venture has the requisite experience and contacts in that market. In that situation, the non-operator partner will focus on transferring its unique technical, business, or financial advantages to the joint venture operator, and may provide its own personnel to the operator to ensure that the transfer of its advantages to the operator proceed smoothly.

Once the initial transfer has been completed, the non-operator may maintain personnel within the joint venture to observe the operator's conduct of business, and learn about the venture market environment so that the non-operator is better

26 Provision can be made for moving to one or both of the other models as time goes by whereby the new party gathers more knowledge and experience in the market. The joint venture also may be converted to a wholly owned subsidiary of one of the parties if it elects to "buy out" the ownership interest of the other party and continues to operate the business on its own.

prepared to expand its responsibilities in the joint venture on its own, at some point in the future.

However, a venture party, which is new to the geographic market, may still assume operator responsibilities. For example, a United States manufacturer may be interested in reducing its production costs by establishing a manufacturing joint venture with a partner in a foreign country where labor costs are much lower than in the United States. Here, the United States manufacturer may have a strong interest in managing the entire process of setting up the factory, the assembly line, training the workers, and monitoring the quality of the production, but may not have in-country experience in the foreign country.

If the primary market for the goods manufactured in the foreign country is outside of the foreign country where the manufacturing facility is located, it may be appropriate for the United States manufacturer, knowing US laws on import/export, customs and sales and distribution, to build, equip and manage the foreign-based manufacturing facility. On the other hand, if the primary market for the goods to be manufactured is the foreign country where the manufacturing facility is located, the United States manufacturer may have the expertise to build, equip, and operate the manufacturing facility, but the foreign venture partner may have more in-country, in-market sales, and advertising and distribution expertise in their home country markets.

This type of approach also may be attractive to the local foreign partner, who may have less knowledge and expertise in the manufacturing process, but who will benefit from the transfer of technical knowledge from the United States manufacturer. The operator model also is commonly utilized by companies which need a high level of cross-border coordination and need to transfer knowledge or technologies to the foreign entrant's global network.

To ensure that the production of the joint venture will continue to be available, the non-operator may bargain for inclusion of an option in the joint venture documents that would allow it in the future to purchase the interest of the operator in the joint venture and, thus, eventually convert the joint venture into a wholly-owned subsidiary.

Shared Control Model

A "shared control" model is based on the premise that both parties have complementary skills and resources that can be contributed to the joint venture in order to create a fully-functional business, and which neither party, working alone, could launch and operate on its own. The shared control model contemplates that each party contributes the resources for which it has a comparative advantage over the other party at the time the joint venture is formed.

The most commonly described example of the shared control model is a company that wishes to enter into a foreign market in which it has little or no knowledge, and does so by selecting a local partner to provide the foreign market support for commercializing its technology and products. In this example, the new partner entrant in the foreign country would be committed to contributing technology, existing products, product development skills, experience, capital, and manufacturing processes and the local partner would provide the necessary resources, labor, personnel and in-country government relations, sales, marketing, and distribution networks.

In a shared model, there will be a number of functions and activities in which the parties must learn how to effectively share control. For example, the foreign party should insist on sharing responsibilities in the finance area with the non-resident venture party. The parties should share the accounting systems of the joint venture. This ensures that the venture parties are not only in compliance with the in-country tax requirements of their respective home countries and in compliance with the tax reporting requirements of the joint venture host country, but also are building mutual trust among the parties in one of the most important areas of the venture, the financial accountability of the venture parties.

To avoid any perceived preference to one of the parties by an accounting firm from one of the venture party's home country, and to ensure independence, a joint venture party may require that the books and records of the joint venture be audited or reviewed by an international accounting firm. While transporting supplies from outside the foreign venture country may be the original purchase source of the venture, as the joint venture grows and local firms in the venture country are qualified, there may be a shift toward purchasing necessary supplies from sources within the local venture country. With regard to banking requirements, the foreign party should require that the joint venture use a local affiliate of a multinational bank that also has offices in the foreign parties' home country.

In the shared control model, the size and composition of the board of directors is an important consideration. Whenever possible, the board of directors should include a senior executive from each of the venture parties since their input can be particularly valuable if conflicts arise, and the assumptions regarding the shared control model begin to unravel. This may occur when one of the parties appears to be exercising more control than the other party anticipated it exercising.

For all of its potential advantages, the shared control model carries a higher risk of failure than the operator model. A joint venture, working under the shared control model, can become paralyzed by indecision, conflict, and gridlock regarding important operational initiatives. Under this type model, it is particularly appropriate to have robust dispute resolution procedures written into the joint venture agreement and operating agreements and to have an active neutral arbitral forum available to resolve issues and have procedures in place to do so quickly to avoid protracted impasses that might endanger the viability of the venture to move forward.

There are also other dangers associated with this model. For example, when employees, working within the joint venture, are initially taken from one partner who itself has independent operations, those employees may continue to have strong loyalties and ties outside of the joint venture organization to key joint venture personnel, including ongoing reporting responsibilities to those same people outside the context of the joint venture. The keys to overcoming the risks of using the shared control model appear to be active participation of the board members and implementation of staffing policies, as described below, that ensure that the foreign party participates in and learns from the joint venture experience from the beginning. Therefore, requiring recognition of these potential problems and allowance for an effective dispute resolution mechanism to resolve ongoing issues between the parties will be important.

Autonomous Model

The third business management model employed in a joint venture is called the "autonomous" model. This model is used when the parties have agreed that the joint venture will operate as an independent entity, free of excessive daily controls imposed by one or both of the parties. Moving joint venture employees off the payrolls of their respective joint venture member companies and onto the payrolls of the joint venture itself is one way of creating loyalty and a stake of those employees in the independent success of the joint venture.

Having employees and managers who are otherwise employed by their member companies simply have a foot in the joint venture but their primary income from their member companies may result in split loyalties, less financial stake, and less willingness to go the extra mile to ensure the independent success of the joint venture.

While the autonomous model may be implemented at the time the joint venture is formed, the more likely scenario is that the joint venture would evolve into this model after the operator or shared control models have already been deployed and not worked, or after the joint venture has reached the point of economic and financial maturity where it can be self-sustaining. Companies that need a high degree of cross-border coordination are unlikely to allow the joint venture to migrate to the autonomous model since they need quick access to management of the joint venture to satisfy needs in other areas of their global network.

Allocating Financial Control of Joint Venture

The relative interests of the parties in the profits of the joint venture are usually determined by their ownership interests in those classes of shares that are entitled to share in any distributions made by the corporation.[27] But share ownership does not always dictate the degree of actual financial control exercised by the parties.

While a majority ownership interest in a joint venture might mandate the assumption that the majority owner will control the entity, there are situations where the majority owner is a non-active investor or where the nature of the party's contribution to the enterprise or where the local laws will require that a party having a minority interest in the profits of the joint venture may be better able to control certain of its activities. For example, for a joint venture to develop a

27 Gutterman and Brown, *Going Global: A Guide to Building International Business, (*2014), chapter 31, section 31.1.18; *International Joint Ventures Handbook*, at pp. 29–36.

real estate project (such as a hotel) in a foreign country, the non-resident majority partner may require a local operator or manager to meet local law requirements regarding real estate ownership. In the course of allocating control of the joint venture, several different factors should be considered including:

- Relative Expertise – Which partner possesses the requisite expertise necessary for achieving the functional and operational objectives of the joint venture? In most cases, control should be allocated in relation to the partner's respective substantive contributions to the joint venture. A party contributing technology to the joint venture, for example, should have the primary right to control the use of the technology in development efforts; a party with responsibility for sales and distribution of the products of the joint venture should be given primary authority over various marketing matters.
- Board vs. Management Control – What is the appropriate scope of authority to be exercised by the shareholders, the directors, the officers, and the managers or members of the joint venture? If the success of the venture depends on its ability to move rapidly to exploit opportunities in the local marketplace, it may be advisable to delegate broader discretion to the officers and managers of the joint venture, with the role of the directors and shareholders being more advisory and long-term strategy in nature. Alternatively, in those cases where the development of the joint venture involves completion of a series of tasks, requiring joint efforts, shared decision-making procedures may be more appropriate.[28]
- Impact of Shared Control – The parties should consider how the use of shared-control requirements (*i.e.*, provisions that require that specified actions must be approved by both parties) will impact the day-to-day actions of the joint venture. While shared control might appear to be an attractive means for easing concerns that might exist at the outset of the relationship, the practical effect of such an arrangement is that burdensome meetings and coordination efforts may unnecessarily divert the parties' attention from, and slow the progress of, the core objectives of the joint venture.
- Financial and Technical Commitments – The manner in which the financial and technical benchmarks of the joint venture are to be monitored and assessed is a key aspect of control. In the course of developing the overall strategic business plan for the joint venture, the parties should carefully identify material and largely irreversible commitments of cash and other resources, as well as the key technical and financial objectives of the joint venture. In some

28 Even in those cases where the parties share nominal control of the board of directors, they may agree as to the delegation of decisions in specified areas to a subcommittee of the board of directors controlled by the party having the expertise in that area. For example, decisions regarding research and development activities might be left to the chief technical officer of the joint venture, appointed by the party with expertise in that area, and a subcommittee of the board of directors controlled by representatives of the appropriate party.

cases, it may be appropriate to abandon or modify the original business plan or transfer control of the joint venture from one party to another.

- Agreed Allocation of Control – A joint venture may be established as a "50-50" enterprise. This generally means that the parties each contribute a relatively equal amount of cash and assets to the joint venture and agree that profits and distributions also will be shared equally. While an economic agreement of this type might suggest that the parties also equally control the management of the joint venture, the partners nevertheless may allocate control over certain decisions of the venture in a manner that departs from shared control. For example, one party might be issued a class of stock having the right to elect a majority of the members of the board of directors, while the other party might be issued a class of stock providing the right to approve certain major actions relating to the affairs of the corporation. If money or capital is the driving force of the joint venture, the majority partner may require more control. If technology and technical expertise, access to local markets, or real estate is the key factor in the success of the joint venture, the local partner may need more control. It also is common for joint venture partners to enter into a contractual agreement providing for the right of each of the parties to designate specific officers and managers of the joint venture.[29]
- Use of Voting Class Rights to Dictate Control – With respect to a joint venture in which one of the parties has a greater interest in the profits than the other party, it is still possible to utilize special class voting rights to provide a minority interest partner with effective control of the joint venture. In addition, local law may provide certain voting rights to minority shareholders that effectively allow them to veto actions taken by the majority shareholder, either directly or, by virtue of their right as minority shareholders, to demand an appraisal of the value of their shares and the repurchase of their interest by the joint venture at the specified value.

Operational Activities of Joint Venture — Covenants

In General

Covenants regarding the internal operations of the joint venture serve several purposes. Importantly, they cause the parties to focus on the day-to-day operations of the venture and the resources that will be required for successful operation. In addition, in those situations where one of the parties will be given control over the management of the enterprise, covenants of this type ensure the non-active partner

29 While the creativity of the parties with respect to allocation of control may be almost limitless, consideration should be given to the requirements of the law under which the joint venture was formed and organized. For example, local law will generally specify certain matters that require separate class votes and may substantially limit the ability of the entity to issue non-voting securities. In addition, regardless of the law under which the joint venture is formed and organized, foreign investment laws and regulations in the home country of the foreign partner may require that local parties have certain minimum rights with regard to control of a joint venture.

that due care and attention will be paid to the business and provide certain standards for measuring the performance of the managing partner.

Typically, a breach of any of the covenants can trigger a "vote switch", in which control of the enterprise reverts to shared management responsibilities or the existing management is replaced in its entirety by agents and representatives supplied by the other party.[30] Again, to the extent that "breaches" are debatable or unclear, a robust dispute resolution process as incorporated into the joint venture and operating agreements can facilitate quick resolution of these issues and avoid crippling impasses.

Terminating Joint Venture

Studies indicate that the average life span of a joint venture relationship is between four and seven years, with few lasting more than 15 years.[31] Therefore, while good intentions of the partners at the outset of a joint venture may dissuade the parties from planning for their dissolution or termination, in reality, the parties

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30 The content of the various covenants between the parties will vary depending on the specific activities of the joint venture; however, one or more of the following items are usually worth considering: (1) The joint venture should be managed in a manner that complies with all applicable laws and regulations, and all filings should be made, and fees should be paid, to maintain the good standing of the business form under the laws under which it is organized. In the event that the activities of the joint venture will be subject to specified regulations, such as export control laws, procedures for ensuring compliance with such regulations should be described in some detail; (2) The parties should agree that all taxes, assessments, and governmental charges will be paid and discharged promptly, subject to the rights of management and the board of directors. In addition, properties of the joint venture should be maintained in good repair, working order, and condition; (3) The parties should agree to cause the joint venture to purchase and maintain appropriate types and amounts of insurance relating to its activities, such as property damage, fidelity bond protection, public liability, workers' compensation, directors' and officers' insurance, and indemnity bonds; (4) If the joint venture incurs any external indebtedness, an undertaking should be provided to ensure that such obligations are paid in a timely fashion; (5) Provision should be made for the deposit of the funds and capital of the joint venture into mutually agreed bank accounts. All withdrawals from the accounts should be strictly regulated in accordance with internal control procedures established by the parties; or (7) The expectations of the parties regarding staffing of the joint venture should be included in the agreement, particularly if there are persons the parties consider essential to the success of the enterprise. In some cases, a provision might be included regarding the purchase of "key person" insurance for one or more individuals.

When the joint venture is to be engaged in detailed development work relating to technology and the associated intellectual property rights, the covenants should describe the plans of the enterprise with respect to securing appropriate statutory rights, including patents, trademarks, and copyrights. As with any transaction involving intellectual property rights, the joint venture documentation should cover the procedures for protecting the technology to be owned or used by the joint venture.

31 *International Joint Ventures Handbook*, section 4. Maitland, "Joint Ventures: Getting out Without Getting Hurt", *Financial Times* (10 October 2002).

should do just that in order to anticipate inevitable changes in the joint venture structure, such as parties who may leave the venture or discontinue the venture.

When parties anticipate a long-term relationship, a first choice for the exit mechanism is a transfer of their joint venture interest; a more burdensome choice is a sale of the company; and the least satisfactory exit mechanism is dissolution of the company. A party wishing to exit the joint venture may want to be compensated for their interest. Generally, transfer of interests can occur in several ways:

- To a third party;
- To the other joint venture parties; or
- To the joint venture vehicle itself.

While not an exhaustive list of questions, in forming the joint venture and contemplating withdrawing party issues, the parties should consider the following:

Basic Planning

What are the bases for the right to transfer shares under applicable law to the joint venture agreement? Will the local law of the place of performance apply to any aspects of the joint venture agreement? What happens if there is a deadlock? How will the joint venture deal with an internal change in control of one of the parties to the joint venture if new management of the party does not support the joint venture? Will the parties choose to lock in their interests for a specified time period?

What happens to the joint venture interests of a party if the other party files for bankruptcy? What priority if any over other creditors will the non-bankrupt joint venture partners have? Can the non-bankrupt joint venture party protect assets or its cash investment in the event its joint venture partner files for bankruptcy? What remedies are available in the home country if a managing director or joint venture partner without authority from the board puts the joint venture into bankruptcy? Is there a provision for transfer of interests if there is ongoing disagreement on capital expenditures? If a party withdraws, would the joint venture have a right of first refusal on the admission of any new party? Would they have the right to purchase the shares of a departing party? Is there a mechanism in place to fairly appraise the shares of a departing party if the venture shares are not publically traded? Are a party's interests assignable?

If so, how is assignment accomplished? Can there be any transfer restrictions? Will the withdrawing party partially assign their interest or must they fully withdraw? Will the parties allow intra-group transfers without prior consent of the other venture party? Will the minority party have tag-along rights? Will the majority partner have drag-a-long rights?

Sale or Distribution

If it is not possible for one venture party to purchase the other party's interests, the next best solution may be to provide for a sale of the company as a going concern. Such a sale will tend to maximize shareholder value since it will require independent valuations and appraisals from sources outside of the joint venture company. In a partial sale of venture interests, the risk is that a competitor may try to take control of the venture.

Here, valuation and appraisal mechanisms, knowledge of local laws and restrictions on the sale of the joint venture, and termination and dissolution will be critical. When a member-party exits the venture, is the exiting/withdrawing party in a position to compete with the venture? Does the joint venture agreement contain non-compete, non-circumvention, or non-solicitation language or have non-compete agreements been contemporaneously executed at the same time as the joint venture agreement or incorporation of the joint venture, to protect the joint venture against one or more of its parties from simply reaping the benefits of the research or technology of the joint venture and withdrawing from the joint venture and competing against the other party with venture research, technology, knowledge, or personnel?

If so, it may be appropriate to implement a non-competition agreement with exiting/withdrawing parties. These will typically be subject to time activity and geographical considerations and may be treated differently under different countries' laws. Some countries may have an absolute prohibition on any anti-competitive conduct; some countries may be less restrictive and encourage open competition; and others may fall in between with some restrictions but limited by geography, markets, products, and time.

There are a number of other considerations to contemplate and incorporate regarding exiting/withdrawing/departing parties, including how disputes regarding exiting parties will get resolved. Disputes regarding withdrawing parties, and dissolution of the joint venture, may be addressed in an arbitration clause or they may be subject to local courts. If such disputes are subject to an arbitration clause, depending on the arbitral tribunal selected by the parties and scope of the dispute issues involved, the arbitral tribunal may decide it can hear such matters, or it may refer those disputes to the local courts that have a nexus to the parties or the joint venture locale.

Winding Up of Joint Venture Company

Unlike bankruptcy, which involves the rights of the creditors and hence third parties, arbitration disputes are, in theory, not matters of public policy. Nevertheless, because of the statutory nature of a company or limited-liability partnership and the right to apply to have it wound up, in some jurisdictions only local courts have the power to grant such relief. Whether arbitrators have the powers to wind up a company will again depend on the relevant national law.

Other Issues

Dispute Resolution Clauses and Mechanisms

The global financial crisis of 2007–2009 triggered a great deal of litigation and arbitration in Europe, but also in Asia, particularly in intellectual property litigation. In addition, the construction industry has seen the downsizing of projects, late payments, and contract terminations. These factors have combined to create an "arbitration boom". The turmoil in financial markets has also led to a swift increase in international disputes, particularly involving investments and financial institutions.

The advantages commonly associated with arbitration are even more relevant in the context of international joint venture disputes. International joint ventures often involve not only the immediate joint venture partners, but multiple contractors and subcontractors to each party, or to the joint venture, or to all. Accordingly, arbitration may be the only acceptable and viable dispute resolution method where all relevant parties to a dispute can appear and resolve their differences.

Arbitration permits the resolution of international disputes in a neutral forum, or at least a forum agreed to by the joint venture parties, by independent decision-makers. By choosing a neutral arbitral tribunal in a joint venture agreement, as the arbitration seat, the joint venture partners can avoid litigating core disputes arising from their relationship and conduct under the joint venture agreement, in courts of the country in which one of the parties is based and avoid the perceived favoritism or bias of those courts.

An arbitration clause in an international joint venture agreement will not completely eliminate either the joint venture party or other non-parties that may be subject to the arbitration of related claims from resorting to the courts of a chosen country to determine such issues as the scope of the arbitration clause, the law applicable to various aspects of the case, whether or not the arbitration can be stayed or compelled, and a range of other issues.[32] While a United States party may be comfortable litigating in United States courts, foreign party venture partners, particularly from non-Common Law-based jurisdictions, may be uncomfortable with United States courts, costs, time, and the confrontational nature of aggressive discovery, foreign language, and possible unsympathetic courts, judges, and juries.

Likewise, United States parties may lack confidence in enforcing their legal rights in the courts of the venture partner's home country or the courts of the venture itself, particularly in undeveloped or emerging market countries with

32 For example, in *Variblend Dual Dispensing Systems, L.L.C v Seidel GMbH7Co,KG*, 970 F. Supp.2d 157 (S.D.N.Y. 2013), the Court determined that New York contract law, rather than the Federal Arbitration Act and the United Nations Convention on the Recognition and Enforcement of Arbitral Awards (New York Convention), applied to the issue of whether a US-based contract assignee was bound to arbitrate the misappropriation of trade secrets and unfair competition claims against one of the original signatories, of the manufacturing agreement, who was based in Germany.

un-established or unreliable judicial systems. Accordingly, the joint venture parties should address early on their agreement to a mutually agreeable neutral tribunal and try and anticipate and address in their joint venture agreement pre-dispute issues that arise, such as jurisdictional issues that may be considered or mandated as local in nature, including corporation laws, real estate rights, and probate issues. In those rare instances of appeals of arbitration awards, or challenges to the enforcement of such awards, even such published cases do not typically discuss in detail the testimony of the parties or the evidence.

Even though arbitration awards are now typically publically available, the arbitration tribunals are considered to be confidential forums since they are the result of a private contract between the parties. Being able to resolve disagreements in private in international joint venture relationships is crucial in cases where the joint venture project is still ongoing and where joint venture partners who are themselves also operating companies or divisions of operating companies may wish to avoid any bad publicity that may arise from a joint venture that failed. Here, the joint venture partners are attempting not only to conduct their joint venture business together, but also to conduct their respective individual businesses.

More and more, parties realize that the disclosure to the public of the joint venture's internal problems and disputes brings unwelcome press and media attention which can damage the reputation of the parties, the business of the joint venture, and impact the viability of the joint venture project itself. If the joint venture parties also are public companies, even though the joint venture may operate independently of its parent company, it is still an investment of the parent company and the fallout from a failed joint venture can have an impact on the parent's stock price.

In specifying a locale, the parties should consider the convenience of the applicability of the New York or Inter-American Conventions so that, if the arbitration is successful, the award will be recognized and enforceable if the award was rendered in a country that is a signatory to those international conventions.[33] Other considerations when determining where the place of arbitration should be are such factors as witness availability, local counsel, transportation, court reporters, hotels, meeting facilities, language barriers, and security and the availability of a pool of qualified and neutral arbitrators.[34] Parties also should be aware that self-proclaimed business ethics monitoring organizations and non-governmental organizations now use the internet to publish "exposes" and "investigative reports" about Western companies doing business in foreign venues alleging exploitation of foreign parties and foreign natural resources. The presence of the internet and the impact such publications can have on businesses increases the need for joint venture parties to increase privacy and private dispute resolution mechanisms.

33 Ochunke, "Arbitrating International Claims – At Home and Abroad", 81 *AmJur Trials*, March 2017 Update, section 75.

34 Ochunke, "Arbitrating International Claims – At Home and Abroad", 81 *AmJur Trials*, March 2017 Update, section 75.

The three most important considerations in drafting an arbitration clause for an international joint venture, to paraphrase the old adage, are "location, location, location". The first location refers to the place of the arbitration. The second location that is important is the choice of forum where the parties can move for judicial assistance to compel arbitration, or enforce an award once made or seek immediate or interim relief. The third location of importance is what country's or state's laws will govern the substantive and procedural issues of the underlying disputes between the parties.[35]

When technical disputes within a particular industry are involved, the parties may want to provide for the appointment of arbitrators with specific technical expertise within the arbitration agreement itself. Different types of joint venture projects and their expected disputes may dictate the need for more technical expertise among arbitration panel members.

In those cases, the arbitration clause should stipulate the requisite qualifications of the arbitrators, and whether their selection should occur before, or after, a dispute has arisen. Projects that likely give rise to more general legal disputes involving less technical-based evidence may be better handled by arbitrators drawn largely from the legal industry and pre-approved by the chosen arbitral forum.

Arbitrability of Joint Venture Disputes

Depending on the nature of the issues involved, most of the disputes arising out of, or in relation to, joint venture agreements will be arbitrable. The scope of the arbitral issues will depend on the comprehensiveness of the joint venture agreement itself. The parties should be as detailed as possible in addressing the tribunal or courts that will resolve threshold legal issues and under what laws they will be resolved. In some cases, the parties may agree to the local courts of the venture country to address certain issues. In other instances, the parties may not trust the courts of the other party and may want to relegate all decisions that are in dispute to the agreed arbitral forum. Assuming the joint venture parties are from different countries or jurisprudential traditions, they will generally insist in their arbitration agreements on a neutral forum to resolve any disputes that may arise.

This includes issues relating to breach of contract, competition law, and intellectual property rights. Other issues usually considered not arbitrable include bankruptcy and matters involving corruption and fraud (as a result of the general prohibition on arbitration of criminal matters).

Minority shareholder claims and statutory claims in general also may be excluded from arbitration in some jurisdictions. These are typically provided for by company legislation in the jurisdiction where the joint venture company is incorporated. This jurisdiction does not necessarily correspond to either the arbitration seat or the applicable law. As previously set forth, the winding up of the joint venture

35 Ochunke, "Arbitrating International Claims – At Home and Abroad", 81 *AmJur Trials*, March 2017 Update, section 75.

company (e.g. resulting from the termination of the joint venture agreement) also may raise arbitrability issues.

Here, the ultimate question is whether the arbitral panel can dissolve the company if the company's shareholders are unable to resolve the dispute. However, this question is viewed differently in different legal systems. Whether arbitrators can validly wind up a company can be viewed as a matter of arbitrability jurisdiction or as a matter of availability of the remedy in arbitration.

Scope of Arbitration Agreement

The scope of the arbitration clause tends to be a relevant issue in joint venture disputes. Subject to their arbitrability, disputes covered by a standard arbitration clause containing the common expression "arising out of or in relation to" include not only contractual but also tort and statutory claims. The interpretation of the scope and breadth of that language can vary among courts in the United States so, therefore, when interpreted in the courts of other countries, there may be multiple interpretations of what is included and not included within the scope of the arbitration clause.

For example, the general rule in England as well as most US Courts is that forum selection clauses are *prima facie* valid and enforceable. In Spain, Italy, Mexico, and Cuba, while the courts favor these clauses, they do not receive *prima facie* priority. Other countries, such as Germany, Belgium, and The Netherlands, require that neither party have a link to the country of the selected arbitral site.[36] For this reason, the drafters of the joint venture agreement should not consent to a governing law unless well-advised of the consequences of such clauses under the countries' governing laws.

Such clauses can be included in the letter of intent, joint venture, or cooperation agreements as well as the company's articles of association. In some circumstances particular to joint venture disputes, the scope of the arbitration clause may be extended *ratione materiae* and/or *ratione personae*. Moreover, when an international joint venture results in setting up companies or corporations in a foreign country, while the joint venture parties' disputes may be subject to the agreed forum in the arbitration clause of the joint venture agreement, issues such as stock transfers, securities offerings, debentures, and corporate director officer liability issues may be mandatorily governed by the corporate law of the country where the operating company or corporation exists.

For example, in a joint venture agreement between a United States company and a Brazilian joint venture partner who agree to arbitrate their claims under ICC rules in Paris or New York, to the extent operating companies have been formed in Brazil, the arbitrators may still be required to apply Brazilian corporate law to issues unique to and arising under corporate duties and regulations even though the joint venture agreement cites ICC rules as governing.

36 Ochunke, Thomas H., "Arbitrating International Claims – At Home and Abroad", 81 AmJur Trials, March 2017 Update, section 75.

Scope Ratione Materiae

In the absence of a conflicting clause in the contract deprived of an arbitration clause (usually an implementing contract or a contract subsequently negotiated in the context of the joint venture), the scope of the arbitration clause included in joint venture agreements may be extended to this contract. Such extension *ratione materiae* will be subject to the existence of a substantial link between the two contracts. This link can be economic[37] or structural, i.e., one contract is complementary to the other or refers to the performance of the other.[38]

Scope of Ratione Personae

The scope of *ratione personae* relates to who can or should be party to arbitral proceedings. The contractual nature of arbitration means that only parties who undertook to submit their disputes to arbitration can be party to it. It often means that there can be no joinder of a third party to the arbitration agreement unless the latter, as well as all current parties to the arbitral proceedings, consent to it.

However, disputes arising from international joint venture parties rarely take place in a vacuum and simply involve the two parties to an agreement. Often, such disputes involve vendors or contractors or creditors who have a claim against the joint venture itself or one of the parties to the joint venture who then proceed to seek financial contribution or indemnification from another party.

In these cases, a body of law has evolved in which there are circumstances under which third parties and non-parties to the original joint venture agreement may either be allowed to litigate/arbitrate their claims under the same arbitration clause signed by the original joint venture parties, or they may be compelled to arbitrate their claims by one or more of the joint venture parties.

37 International Chamber of Commerce Arbitration Number 7929 (partial award), 1995 *Yearbook* (XXY), 2000, at p. 312.

38 In International Chamber of Commerce Arbitration Number 8342, the arbitrator proceeded to the analysis of the link between the joint venture agreement and the implementing agreements stemming from it. The reasoning was based on the theory of “group of contracts”. Given that both the joint venture agreement and the implementing agreements were part of the execution of a single project, a breach of an implementing agreement amounted to a breach of the joint venture agreement. The scope of the arbitration clause contained in the joint venture agreement could therefore be extended to this implementing agreement.

41 *E.G. Bridas, S.A.P.I.C et al v Government of Turkmenistan, et al,* 345 F.3d 356.

Non-Signatories to Arbitration Agreements under United States Domestic Laws

In General

"Generally, [A]rbitration is a matter of contract. A "party cannot be required to submit to arbitration any dispute which he has not agreed so to submit".[39] While a contract cannot bind parties to arbitrate disputes that they have not agreed to arbitrate, "[i]t does not follow . . . that under the [Federal Arbitration] Act an obligation to arbitrate attaches only to one who has personally signed the written arbitration provision."[40]

A party can agree to submit to arbitration by means other than personally signing a contract containing an arbitration clause. Well-established common law principles dictate that in an appropriate case, a non-signatory can enforce, or be bound by, an arbitration provision within a contract executed by other parties.[41]

Which Law Governs the Issues of Arbitrability of Non-Signatory Claims or against Non-Signatories

United States Federal and state courts have recognized that "[i]t does not follow . . . that under the [Federal Arbitration Act] an obligation to arbitrate attaches only to one who has personally signed the written arbitration provision;" instead, under certain circumstances, principles of contract law and agency may bind a non-signatory to an arbitration agreement.[42]

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39 *United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, at p. 582, 80 S. Ct. 1347, 4 L. Ed. 2d 1409 (1960); *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. 643, at p. 648, 106 S. Ct. 1415, 89 L.Ed. 2d 648 (1986).

40 *Fisser v. International Bank*, 282 F.2d 231, at p. 233 (2d Cir.1960).

41 For example, in *J.J. Ryan & Sons v. Rhone Poulenc Textile, S.A.*, 863 F.2d 315, at pp. 320 and 321 (4th Cir., 1988), the court noted that when allegations against "a parent company and its subsidiary are based on the same facts and are inherently inseparable, a court may refer claims against the parent to arbitration even though the parent is not formally a party to the arbitration agreement". The "same result has been reached under a theory of equitable estoppel". *J.J. Ryan & Sons v. Rhone Poulenc Textile, S.A.*, 863 F.2d 315, at pp. 320 and 321 (4th Cir. 1988); *Sunkist Soft Drinks, Inc. v. Sunkist Growers, Inc.*, 10 F.3d 753, at p. 757 (11th Cir. 1993) (holding that because claims against non-signatory parent were "intimately founded in and intertwined with" a contract containing an arbitration clause, signatory was estopped from refusing to arbitrate those claims); *Hughes Masonry Co. v. Greater Clark County Sch. Bldg. Corp.*, 659 F.2d 836, at pp. 840 and 841 (7th Cir. 1981) (finding signatory equitably estopped from repudiating arbitration clause in agreement on which suit against non-signatory was based).

42 *Fisser v. Int'l Bank*, 282 F.2d 231, at p. 233 (2d Cir., 1960), *quoted in Int'l Paper Co. v. Schwabedissen Maschinen & Anlagen*, 206 F.3d 411, 416 (4th Cir. 2000), and *Thomson-CSF, S.A. v. Am. Arbitration Ass'n*, 64 F.3d 773, at p. 776 (2d Cir. 1995); *Washington Mutual v. Bailey*, 364 F.3d 260, at p. 267 (5th Cir. 2004) (*quoting Thomson-CSF*, 64 F.3d, at p. 776); *In re First Merit Bank*, 52 S.W.3d 755 (*citing Nationwide of Bryan, Inc. v. Dyer*, 969 S.W.2d 518, 520 (Tex. App. -Austin 1998, *no*

Although state law determines the validity of an arbitration agreement, courts have applied both federal and state law to determine the related, but distinct, issue of whether non-signatory plaintiffs should be compelled to arbitrate their claims. The Federal Arbitration Act does not specify whether state or federal law governs, and the United States Supreme Court has not directly addressed the issue. Federal courts of appeals, however, have frequently applied federal substantive law when deciding whether a non-signatory must arbitrate.

United States Rules Regarding Non-Signatories

Various courts in the United States have developed several rules or theories under which a Court may compel a non-signatory to an underlying arbitration to arbitrate. Federal courts have recognized six theories, arising out of common principles of contract and agency law that may bind non-signatories third parties to arbitration agreements between joint venture parties: (a) incorporation of the joint venture parties' arbitral agreement by reference in the third-party contract, (b) third-party assumptions of obligations in the arbitral agreement, (c) agency-agents of a principal who signed an arbitral agreement may be bound by their principals' agreements, (d) third parties that are alter egos of a party to an arbitral agreement, (e) third parties who try to accept benefits of an arbitral agreement may be bound by equitable estoppel principles, and (f) third-party beneficiaries of an agreement which is arbitral may be bound.[43]

Remedies

As a general principle, arbitrators have the powers granted to them by both the parties (directly in the arbitration clause or the submission agreement and indirectly in the arbitration rules adopted by the parties) and the arbitration law applicable to the procedure. Moreover, because of the contractual nature of arbitration, arbitrators only have powers over parties to the arbitration agreement. This restriction obviously impacts upon the type and magnitude of relief capable of being granted by arbitral panels and the extent to which these are enforceable.

Experience also shows that addressing contractual remedies in the joint venture agreement puts the parties in a better position if disagreement arises as to the future of the joint venture. Providing detailed and comprehensive rights exercisable in case of breach or deadlock, and reducing the tribunal's discretion to hear the issues in arbitration or defer them to local courts, will help the parties add predictability and security to their agreements.

pet.)); *S.W. Tex. Pathology Assocs. v. Roosth*, 27 S.W.3d 204, at p. 208 (Tex. App. San Antonio 2000, *pet. dism'd w.o.j*.).

43 *Bridas, S.A.P.I.C et al v Government of Turkmenistan, et al,* 345 F.3d 356 (5th Cir. 2006); *Thomson-C.S.F., S.A. v. American Arbitration Ass'n*, 64 F.3d 773, at p. 776 (2d Cir. 1995); *DuPont*, 269 F.3d 195 (3d Cir. 2001); *Javitch v. First Union Securities, Inc.*, 315 F.3d 619, at p. 629 (6th Cir. 2003).

Final and Enforceable Awards

Often, investment projects are operated on an international basis with business partners and/or joint venture companies located in different countries. Under the New York Convention 1958 and its ratification by more than 140 countries, a foreign arbitral award is more easily enforced overseas than a judgment delivered by a domestic court.[44]

Moreover, joint venture partners are normally eager to obtain a fast resolution of the dispute in order to be able to make a decision as to the future of their joint venture, if still existent/viable. As a result, arbitration's unique features of absence of (or restricted) appeal and limited grounds for challenge of the award increasingly attract parties driven by business priorities and cost control.

Transfers of Shares

Transfers of shares and termination of the joint venture agreement may be more controversial than traditional money damages arbitration, but will sometimes be central to the resolution of a deadlock in a joint venture dispute. Subject to relevant national law, arbitral tribunals generally have the power to order a transfer of shares that was specifically contemplated in the joint venture agreement or which is authorized under the controlling corporate law of the country or jurisdiction of the corporate entity involved.

Some corporate laws govern what happens in a deadlock situation. If the parties have not anticipated and addressed this situation in their joint venture agreement, a deadlock situation may be governed by default under the relevant corporate law or it may be left to the decision makers or an arbitral panel.

Where there is a deadlock or where some actions on the part of a party have jeopardized the relationship, a tribunal may be unable to resolve a deadlock between the parties because it cannot substitute itself for the board of directors and the shareholders in the decision-making. In some circumstances, a corporate "divorce" and the termination of the joint venture agreement is the only viable solution and a remedy sought by at least one of the parties. In the presence of an exit/termination clause in the joint venture agreement (e.g. "blind bid mechanism" or "Russian roulette"), the arbitral panel will apply the contractual procedure and remedies. Upon a party's request, the tribunal could declare that the clause requirements are met, and order the failing party to participate in the procedure provided for in the agreement. This is the best scenario — indeed, when no exit

44 The New York Convention 1958, articles II.1 and V.2 (a), as well as most of the international arbitration regimes provide that their application is limited to disputes capable of settlement by arbitration. Excluded from this list are the types of disputes that belong exclusively to the domain of the court under the relevant domestic law. Given that jurisdictional challenges, including on grounds of arbitrability, can potentially be made at different stages in the arbitral proceedings, the *lex arbitri* (usually the law of the seat), the law applicable to the substance and the law of the place of enforcement, are likely to be relevant in determining whether the dispute is arbitral.

clause is provided in the joint venture agreement, granting of such remedy will be at the entire discretion of the tribunal and therefore uncertain.

Multi-Party Arbitration

Joint venture stakeholders should bear in mind that the joint venture company may not become a party to the arbitral proceedings, unless it was party to the original arbitration clause in the joint venture agreement or the joint venture is subsequently joined in the arbitration under one of the theories recognized by the courts for joining third-party non-signatories. Issues inherent to multi-party arbitrations tend to arise with even more relevance in the context of joint venture disputes. These include establishment of the tribunal.

Consolidation of disputes arising out of the same project, but among parties who are not privy to a common agreement with an arbitration clause, can only be agreed on by all the parties to the proceeding to be consolidated as well as the tribunal. Although not excluded in principle, consolidation is far from guaranteed. As a result, failure of the parties to contemplate a dispute resolution mechanism encompassing disputes involving all the stakeholders in the project may portend a considerable increase in arbitrations, legal costs, and the risk of inconsistent rulings. For instance, parties could agree that a tribunal constituted in accordance with the arbitration agreement will remain in existence until it declares itself to be *functus officio*.[45] In this way, a party to the arbitration agreement will be able to submit a "fresh dispute" within the scope of the arbitration agreement without the need of the consent of the tribunal and the parties to the pre-existing dispute(s).

Conclusion

The globalization of international business relationships inherently leads both to a proliferation of international joint venture and multi-party collaboration agreements. Many will fail and those who do not may have short time spans. But careful planning will improve the chances of success and longevity. Arbitration is the natural dispute resolution method for international disputes, and this is even truer for international joint venture disputes.

However, if the remedies required are either not available within the process or are not recognized by subsequent local court intervention, the international business community may eventually lose faith in the arbitration process. Regardless of whether parties may believe that dispute resolutions and termination procedures are "non-deal friendly", it is paramount that parties considering entering joint ventures with foreign partners carefully analyze not only the merits of the venture and their venture partners and the risks in the venture host country, but also incorporate into their joint venture agreements any particular remedies and how

45 Wetter, "A Multi-Party Arbitrator Scheme for International Joint Ventures", *Arbitration International*, volume 3, number 1 (1987), at pp. 2–13.

to enforce them in the event the venture must be dissolved or is breached by one party or the other.

Although international arbitration provides the parties with great flexibility, its span and its applications are somewhat limited by the contractual nature of arbitration. Parties and their counsels should be aware of these limitations and address possible future disputes at the outset through careful and comprehensive drafting of the arbitration clause in their joint venture agreements.