International context

Insofar as this is a textbook, it is based on English law—but most issues and solutions in these types of transactions are relevant whatever the nationality of the parties and wherever the joint venture or alliance is based. Very many joint ventures and alliance have an international dimension. The globalisation of business is leading in many respects to a convergence of practice, approach and solutions in the way these types of transactions are structured and documented. If this book in some small way assists lawyers engaged internationally on these interesting (and often challenging) transactions, we will be particularly pleased.

"Brexit"

The referendum on UK's membership of the EU has given rise to a verdict of "leave". Many years of complex constitutional and legal measures to disentangle or, in many cases, to restructure the UK's engagement with EU-originated laws will follow—including, in our context, measures in the fields of competition, tax and employment law. This is not the edition for detail or, indeed, speculation. Much may, in substance, depend on the extent to which the UK retains, in some form, access to the European single market. At the commercial level, however, it will be interesting in the coming years to see whether proposed "Brexit" will dampen investment by UK companies into other (existing) EU countries and/or lead to ever greater UK investment (including through joint ventures and alliances) into growing economies outside the EU.

Changes in this edition

Laws and practice relating to joint ventures and alliances do not stay still. It is five years since the last edition of this book. There are, cumulatively, many changes reflected in this 6th edition.

- Planning and preparation for a joint venture has proved ever more important for its success—and for identifying earlier the challenges and potential problems. More emphasis has been placed on this important stage.
- The Bribery Act 2010 has shown its teeth. Further Government guidance and experience (including the first prosecution) have made anti-bribery and corruption investigations and protections a key feature of doing business through a joint venture.
- If a jointly-owned limited liability company remains the most common legal form, experience has shown the limited liability partnership (LLP) to be a viable and flexible entity for many ventures. The rules relating to limited partnerships have eased, at least for private fund limited partnerships. European models may (subject to "Brexit") still be considered but progress on the European private company (SPE) has stalled.
- Governance of joint ventures has received increasing attention. Some conclusively) the thorny issue of the duties of a director wrestling between his duties to the joint venture company and allegiance to the corporate party that appointed him.
- A feature of the last few years in the courts, as forewarned in the last edition of this book, has been a number of cases alleging an implied duty of good faith, or similar, in contractual relationships—with indications from cases such as *Yam Seng Pte Ltd v International Trade Corporation* that a particular doctrine may be developing with regard to "relational contracts" such as joint ventures. The Court of Appeal in *Ross River v Waverley Commercial Ltd* has also explored the scope of fiduciary duties owed where one party has placed heavy reliance on another, controlling, party in relation to the conduct of the joint venture operations.
- The Supreme Court's recent decision in *Cavendish v El Makdessi* has radically re-appraised the law on penalties with important consequences for "default" provisions in joint venture situations.
- On exit, increasing use has been made in the UK of the "solvency statement reduction" under the Companies Act 2006 as a way of enabling a party to exit a joint venture company. On share transfers, the Court of Appeal in *Re Coroin Ltd* and *McKillen v Misland (Cyprus) Investments Ltd (No 2)* has clarified, at least to some extent, the scope of typical pre-emption provisions and the position if a party attempts to transfer its shares without complying with them.
- The importance of effective dispute resolution does not diminish—with increasing provision for mediation in dispute settlement and a distinct rise in investor-state arbitration under international bilateral investment treaties (BITs). New regional arbitration centres have developed. Meanwhile, the Supreme Court's decision in *Jivraj v Hashwani* has, fortunately for London's position as a pre-eminent venue for international arbitration, preserved the ability of parties to designate requirements of nationality or other characteristics in relation to arbitrators appointed to hear their disputes.
- Substantive changes have taken place in specialist areas which impact significantly on joint ventures—particularly developments in taxation, employment and EU competition law. Important changes have taken place in relation to the accounting treatment of joint ventures and alliances with the introduction of FRS 102.
- The international dimension continues to be integral to this book, with issues being addressed throughout in a way potentially applicable to joint ventures wherever located. In relation to specific jurisdictions internationally, we have chosen in Part D to concentrate on a few selected countries where "foreign" investment through joint ventures with "local" parties is common—and local lawyers have identified particular issues which provide challenges for companies (and their lawyers) investing in those countries. We believe this is a constructive and educative approach and are delighted that lawyers from Brazil, China, India, Malaysia and the United Arab Emirates have made this contribution.
- More generally, a feature of the last few years has been the number of

through footnotes, we provide reference to an increased number of legal cases which have arisen before the English courts relevant to issues addressed.

- Lastly, but not least, the opportunity has also been taken generally to revise and refresh the text in a number of areas.

Joint ventures involve, in effect, the creation of a new business enterprise. This can be a source of satisfaction not only for the parties themselves but also the lawyers who form part of the team. Working with many able co-contributors, we hope that this book will provide a useful basic tool-kit for lawyers and other professionals engaged in this important area of commercial activity.

Ian Hewitt
Simon Howley
James Parkes

1 August 2016

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Ian Hewitt
1 August 2016

This book, as with joint venture relationships generally, has relied heavily on contributions by many different people. We, as co-editors, are extremely grateful to a number of lawyers at CMS Cameron McKenna LLP who, despite busy client practices, have contributed in "specialist" areas affecting joint ventures, particularly:

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China	Falk Lichtenstein *(CMS, China)*
India	Rabindra Jhunjhunwala and Tarunya Krishnan *(Khaitan & Co, Mumbai)*
Malaysia	Abdullah Abdul Rahman, Brian Foong

CHAPTER 3

CHOOSING THE LEGAL FORM

A "joint venture" is not a legal term of art. There are few jurisdictions in which it is a defined form of legal relationship. Businessmen use the terms "joint venture", "alliance" and "partnership" in a loose sense. These terms reflect a business strategy of collaboration. This strategy can be pursued in a number of different legal forms. A broad range of potential vehicles exists worldwide for structuring joint ventures and alliances. This chapter examines some of the key issues in deciding the legal form for a particular venture.

Basic legal categories

3-01 We start with first principles. The legal forms for joint ventures and alliances can most easily be classified into the following basic formal categories:

(a) contractual alliances;
(b) partnerships;
(c) corporate joint ventures.

There also exist a number of "hybrid" structures or arrangements. The most notable in the UK is the limited liability partnership ("LLP") which is a corporate entity but has many features of a partnership. It is convenient to bring together these "hybrid" forms separately later in this chapter.

KEY ISSUES

Key issues in deciding the legal form

3-02 In many cases, the legal form of the joint venture or alliance "vehicle" and the location of any joint venture entity will be clear from the circumstances of the venture. In others, it will require careful and imaginative planning. In these more complex cases, decisions will be influenced by a variety of commercial, legal, tax, regulatory and accounting considerations. Key issues, particularly in relation to an international joint venture involving assets and/or parties in different jurisdictions, include the following:

LEGAL FORM: KEY ISSUES

(1) *Integration of assets/business.* How far do the parties wish to integrate the venture's business operations and associated assets and liabilities? A corporate entity or partnership undertaking enables full integration; in a contractual alliance, although collabora-

(2) *Liability exposure.* Is it important for the parties to have the benefit of limited liability which a corporate entity for the venture will generally provide—or is this, in practice, not a material concern?[1]

(3) *Tax cost.* Tax will frequently influence the choice of structure, particularly in the case of an international venture. What will be the tax costs in relation to: establishment of the joint venture? ongoing operations of the joint venture? repatriation of profits? financing and interest payments? These and other related issues are addressed in more detail in [illegible].

(4) *Competition law factors.* The regulatory treatment of the joint venture may vary depending on the structure. There may be advantage, for instance, in structuring the venture as a "full-function" joint venture in order to fall within the one-stop clearance regime of the EC Merger Regulation—or structuring the terms of the alliance (e.g. a research and development collaboration) so as to fall within one of the accepted exemptions. Chapter [illegible] addresses these issues.

(5) *"Local" jurisdiction requirements.* Do regulations or customs in the "local" jurisdiction applicable to foreign investment effectively require a certain type of entity—either to conduct business or to hold a requisite form of licence? If a jointly-owned venture requires a relevant regulatory licence, a distinct corporate entity may be required.

(6) *Ease of termination and unwind.* Is it desirable to adopt a legal form such as a contractual alliance which enables the venture easily to be terminated if a party becomes dissatisfied or wishes to "exit" or which enables the venture to be wound-up more easily if it fails or completes its purpose?

(7) *Management structure.* Is it desirable to have a legal form (e.g. a company) which has an entity with which senior management can clearly identify and which can have its own separate employment structure? Or is it preferable to have flexibility and for each party to have greater control over the management of its own resources, which a contractual alliance generally offers?

(8) *Funding cost.* Will a particular structure reduce the cost of financing the venture? Is it better for a separate joint venture entity to be located in a jurisdiction where it can itself raise finance cost-efficiently—or is financing more efficiently raised by the parties in their own or other jurisdictions? Should the venture be structured through a limited liability entity which may enable operations to be independently funded on a non-recourse basis? Chapter 7 addresses some of these issues.

(9) *Accounting treatment.* How will the assets and liabilities, and profits and losses, of the venture be reflected in the accounts of the joint venture parties (or their parents)? For instance, in the case of a UK parent, is it desirable—or acceptable—for the results of the venture to be consolidated as a "subsidiary undertaking" or is it preferred to achieve a form of "equity accounting"? Is it preferable to avoid debt of the joint venture entity being consolidated on the parent group's balance sheet? The nature of the joint venture vehicle and the parties' percentage interests therein may affect this accounting treatment. Chapter [illegible] addresses these accounting issues.

(10) *Transferability.* Is it preferable to have a structure (usually involving a separate corporate entity) which could in due course enable one party to transfer its interest, or new participants to be introduced, without legally disrupting the ownership and running of the underlying business?
(11) *European "feel".* Is it advantageous, for political or other reasons, to use a vehicle that has a non-national "feel"? If the parties are from different European countries, consideration might be given to using one of the "European" models—e.g. a European Company (SE), a European Economic Interest Grouping (EEIG) or (possibly in the future) a European Private Company (SPE).
(12) *Nationality considerations.* In the case of a joint venture or alliance with operations in different jurisdictions, are there national considerations—e.g. arising from political profile, tax costs or identity of the participants—which lead to a preferred structure of direct participation by the "national" companies and structuring the venture through a contractual linking of the joint operations? Possibly, an overall structure of parallel joint venture vehicles in different jurisdictions, or in different fields, may be appropriate rather than a single joint venture company with subsidiaries.
(13) *Reporting and publicity requirements.* Is it important or desirable to use a legal form which does not involve any material financial reporting or public filing requirements (e.g. avoiding the requirement to file annual accounts applicable to a UK limited company)?
(14) *Administrative cost.* Is it unduly burdensome to adopt a legal form which will involve ongoing administrative requirements imposed by statute (e.g. the preparation and filing of annual accounts, keeping of statutory records and other statutory requirements normally applicable to a limited company)?
(15) *Formalities of formation.* Is it desirable to have a structure which can be set up quickly without undue formality or costs of registration?

The weighting to be given to each factor will vary from venture to venture. It is important to adopt a legal structure appropriate for the commercial requirements of the particular venture. In many cases a corporate joint venture will provide the identity, permanence and integration commercially required; in other cases, a corporate joint venture may be unduly cumbersome to govern and operate (or unravel) for the kind of flexible alliance contemplated by the parties.

One importance of the chosen "legal" vehicle is that this selection affects the level of customised drafting necessary to establish the desired "business" relationship. The particular legal form will have its own framework and involve a number of background rules which will apply in default of any customised drafting.

(1) A corporate entity invariably brings with it a statutory code of corporate laws governing, with varying degrees of flexibility, the structure for the company and its management. Formal constitutional documents will be required to establish the entity.
(2) A partnership usually brings into play a background statutory code (although more limited than for a corporate entity) which will apply in default of any customised rules. A partnership will involve certain general partnership law principles.
(3) A contractual alliance is formed purely by the contractual agreement between the parties. The specific contract terms adopted by the parties operate against a background of the general law of contract.

3-03 The choice of legal form and these background legal factors can—subject to any

e.g.:

(a) the governance and management structure and division of powers between the "owners" and the "managers" of the business;
(b) rights of the individual parties (or their representatives) to bind the joint entity or alliance in respect of debts and obligations incurred during transactions with third parties;
(c) any fiduciary duties owed between the respective participants in the venture (or to the joint venture entity);
(d) the ability of a party to transfer its shares or interest in the joint venture to a third party;
(e) rights to terminate or wind-up the venture; and
(f) ease or ability to introduce new participants into the venture.

The legal form chosen for the venture will, similarly, dictate the basic form of documentation required to establish the relationship—particularly if a corporate entity is selected, with its statutory requirements for incorporation and articles of association (or by-laws). Choosing a vehicle which involves an inappropriate legal framework or set of default rules can increase the cost and time associated with joint venture formation.

CONTRACTUAL ALLIANCE

An unincorporated alliance, based on a simple contract between the parties detailing their co-operation, will suffice for many collaborative ventures and projects. (In this book, we tend to use the term "alliance" rather than "joint venture" for this legal form.) This form does not involve the creation of a separate legal entity. Such an arrangement usually involves the sharing of costs and resources, and sometimes revenue on terms which do not give rise in law to a "partnership". However, beware if the arrangements do include the sharing of net profit or loss—this will commonly give rise to a partnership in law in many jurisdictions. 3-04

Figure 3.1 CONTRACTUAL ALLIANCE

A — contract — B

This diagram reflects a simple two-party alliance. A contractual alliance may, and frequently will, comprise a multi-party network of parties whose contributions, joint operations and collaborative relationship are governed by contract.

Advantages/disadvantages of a contractual alliance

A contractual alliance has a number of potential advantages and disadvantages. It will rarely, though, be an appropriate medium for the parties if they wish to establish a full "equity" joint venture. The advantages of a contractual alliance can include: 3-05

(1) *Lack of formality.* The lack of formality may be a positive feature in forming, administering, revising and/or ending the venture.

ment and employees will not transfer their employment. A contractual alliance can be less cumbersome to manage than a corporate entity which will require a formal and distinct management structure.

(3) *Ease of termination and unwind.* A contractual alliance will generally be easier to terminate and unwind if a party wishes to end the venture or if the venture completes its purpose. This may be particularly important if the alliance is likely to be a relatively short-term collaboration.

(4) *Tax transparency.* In many cases, greater tax efficiency can be achieved through using such a structure by reason of its tax "transparency". Expenditure will be incurred directly by the alliance parties (and be capable of being set off against their own respective profits) rather than through a separate corporate entity. This "transparency" may be particularly valuable if losses are expected in the early years of the venture and the parties wish to have the benefit of those losses or other tax allowances in their own tax jurisdictions—see para.15-05.

(5) *Flexibility.* Generally, the relative ease of amending terms and adapting the relationship, without the formality involved in a corporate structure, can be an advantage—particularly in a fast-changing industry sector.

A contractual alliance can, though, bring into play factors which may be regarded as disadvantages in many circumstances:

(1) *Lack of identity.* Such a structure can lack substance or identity (compared with a corporate entity) for marketing purposes or for ease of dealings with third parties.

(2) *Lack of firm organisational structure.* A contractual alliance is sometimes regarded as lacking a sufficiently firm organisational structure for employing senior management attached to the venture (compared with a joint venture company where they can be directors of a company or belong to a clear employment structure within a corporate entity). The looser structure may have the consequence that monitoring the other joint venture party's activities or contribution is not as close as it would be in a more hierarchical corporate structure—a concern if there is a danger of "opportunistic" behaviour by the other party.

(3) *Risk of partnership.* An unincorporated venture can cause potential problems in many jurisdictions, including unwanted tax consequences, if the arrangements constitute a partnership in law—see para.3-11.

(4) *Transfer.* An unincorporated venture, although generally easy to terminate and unwind, is less suitable if a party is likely at a later stage to seek to transfer its interest in the joint venture activity to a third party.

(5) *Competition law.* Collaborative arrangements, particularly alliances between independent competitors, can give rise to more difficult issues and analysis under anti-trust laws relating to co-operative agreements than a "merger" through a separate entity.

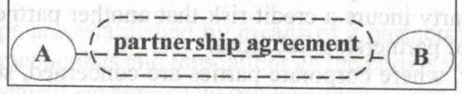
(6) *Need for "bespoke" drafting.* A contractual alliance depends solely on contract without the background of established corporate procedures and laws. This can sometimes be an advantage (especially in terms of flexibility) but also leads to the need for carefully drafted rules and documentation when establishing the venture. A complex contractual alliance can involve detailed and "bespoke" drafting.

alliances include: project bidding agreements; research and development collaborations; specialisation or joint production agreements; resource sharing arrangements; supplier/customer "partnerships"; and multi-national services networks or other strategic alliances. Some of these particular arrangements are examined more fully in Ch.4.

PARTNERSHIPS

A "partnership" as a legal form is simply an unincorporated arrangement, founded in a contractual relationship between the parties, which has the requisite hallmarks for partnership applicable in the relevant country. What constitutes a "partnership" will, therefore, vary from jurisdiction to jurisdiction. In some countries, the relationship will have its own legal personality—similar to a corporate entity—but a common factor running through all partnership models is that some or all of the partners will have joint and unlimited liability for the debts and liabilities of the partnership business. Although historically more common as an arrangement between individuals, there is no reason (at least under English law) why a partnership should not exist between partners who are themselves corporate entities. 3-06

Figure 3.2 PARTNERSHIP



Again, the diagram in fig.3.2 represents a simple two-party partnership. Many partnerships will, though, comprise a multi-party relationship.

Since a partnership involves sharing of profits and losses, it is a potential legal form for an equity joint venture. The use of the partnership model is, in practice, relatively rare for a commercial joint venture business in the UK—although some contractual alliances may (unintentionally) cross the line into a "partnership" at law. However, many variants exist in civil law systems and their use is quite common in many continental European countries as a joint venture structure.

Advantages/disadvantages of a partnership

There may be good reasons, particularly in view of the tax transparency of most forms of partnership, to use this type of joint venture vehicle for structuring international equity joint ventures. A partnership—at least in the UK—may have several advantages, including: 3-07

(1) *Flexibility and simplicity.* A partnership offers flexibility and simplicity of formation (e.g. with no registration or other formalities required for formation under English law) and the governing rules of the partnership can be written down and varied easily.

(2) *Tax transparency.* Tax transparency or "pass through" (with profits and losses being treated directly as those of the partners in their proportionate shares) may be advantageous for tax planning purposes and may enable the

ing filings with any regulatory body (such as the Companies Registry) can be an advantage; but see para.19-02 below in the case of filings of audited accounts by UK corporate partners in a partnership.

The disadvantages of a partnership as a joint venture vehicle may include:

(1) *Absence of corporate identity.* A partnership can suffer in comparison with a corporate entity which can give the vehicle greater "identity" by separately owning the assets and liabilities of the joint business and provide a clear framework for a central management structure.[2]

(2) *External finance.* A partnership offers less flexibility than a corporate entity for obtaining external finance (e.g. except to a very limited extent, a partnership cannot create a floating charge as security under English law and non-recourse project finance will not usually be available).

(3) *Liability.* A disadvantage of a partnership, for many, is that each partner has joint and unlimited liability for debts and obligations incurred by the partnership or by any partner acting within the express or implied scope of the partnership business and is jointly and severally liable where the partnership is responsible for wrongs suffered by third parties. As a result:
   (a) liability is not limited to the capital contributions of the parties;
   (b) each party incurs a risk that another partner may act outside internally-agreed authorisation procedures and trigger liabilities to third parties on behalf of the partnership; and
   (c) each party incurs a credit risk that another partner may not meet its share of partnership liabilities.

   However, where corporate parties are concerned, some of the difficulties which unlimited liability might cause can in practice be mitigated by establishing a partnership between specially-formed subsidiary companies of the participants.

These various disadvantages (taken with other practical considerations) mean that, in the absence of strong tax considerations or professional requirements, it is comparatively rare to find a commercial joint venture business intentionally established in the UK as a partnership.

When does a partnership exist?

3-08 What constitutes a partnership will depend on the law of the relevant jurisdiction. In joint ventures, the test of "partnership" is generally satisfied if there are contractual arrangements between parties establishing a common business or undertaking—particularly one in which the parties share in profits and losses. This relationship can lead to specific consequences under the partnership law of the relevant jurisdiction.

A partnership under English law is established when the statutory criteria of the Partnership Act 1890 are met, namely: "the relation which subsists between persons carrying on a business in common with a view to profit".[3] If the courts are called upon to decide whether or not a partnership has been established, they will consider

[2] In Scotland, however, a partnership does have separate legal status and can sue and be sued in its own name.

[3] Partnership Act 1890 s.1(1). In *Dutia v Geldof* [2016] EWHC 547 (Ch), the court distinguished

all of the circumstances of the relationship including, particularly, the following factors[4]:

(1) A partnership cannot exist without a business. There must be some commercial venture, although "business" is widely defined to include "every trade, occupation or profession". It seems that a business can, for this purpose, exist without the element of continuity; accordingly, a single venture can in appropriate circumstances be a business. For a business to be carried on "in common", there must be participation in the business by two or more parties. Generally, carrying on a business indicates that each of the partners should be entitled to a profit share, although this is not essential. The key characteristic is the carrying on of business in such manner as to make each partner the agent of the other for all acts done in the course of the business.[5]

(2) Profit-sharing can cause particular difficulties. It may be necessary to decide, for instance, whether a financial return linked to profit from a business is that of a partner or a creditor or simply consideration under a contract for goods or services.[6]

(3) Sharing of losses, if any, creates a strong presumption of partnership. The element of risk is an indication of true participation in a business. This is irrespective of any stipulation in the agreement between the parties.[7]

Most partnerships are established by means of a partnership agreement. The normal law of contract applies and thus, although the parties will often enter into a formal written agreement, an agreement can be inferred from a course of dealings. A partnership commences under English law when the criteria of the 1890 Act are met.[8] This is a mixed question of law and fact. It follows that any commencement date which the parties stipulate is not conclusive.[9] Particular difficulty may arise

partners should carry on business themselves. A business carried on by a corporate body is not carried on by its members, and having an ownership stake in a corporate entity that carries on a business as a partner with another party is not the same as carrying on a business oneself—even if the owner agrees to work for the business being carried on by the partnership.

[4] *Cox v Hickman* (1860) 8 HL Cas 268. While s.1(1) of the 1890 Act lays down the criteria for a partnership, s.2 provides certain guidelines for determining whether or not those criteria have been met. These can be summarised as follows: s.2(1): co-ownership of property does not of itself create a partnership as to anything so held; s.2(2): the sharing of gross returns does not of itself create a partnership; and s.2(3): the receipt by a person of a (net) share of the profits of a business is prima facie evidence that he is a partner in the business.

[5] See *M. Young Legal Associates Ltd v Zahid Solicitors (a firm)* [2006] EWCA Civ 613.

[6] Section 2(3) of the 1890 Act gives a number of specific examples where the receipt of a financial return does not of itself evidence a partnership. These include: s.2(3)(d): the payment of loan interest out of profits; and s.2(3)(e): payment for goodwill out of profits.

[7] *Fenston v Johnstone (HM Inspector of Taxes)* [1940] 23 T.C. 29. One party wished to purchase and develop a piece of land. The other party advanced funds. The parties agreed to share in the profits and to be responsible for one half of any loss. The court decided that a partnership was created despite an express term stipulating that the arrangement should not constitute a partnership between them.

[8] In *Khan v Miah* [2001] 1 All E.R. 20 it was held that, even though actual trading had not commenced, the parties had embarked on a business activity (by making positive preparations for a restaurant) and had commenced the joint enterprise in which they had agreed to engage in partner-

when parties decide to form a joint venture company but commence the business in common before the company is formed.[10]

General partnerships

United Kingdom

3-09 The usual form of partnership in the UK is a general partnership under which each partner has joint and unlimited liability for the debts and obligations of the firm (even if a creditor must look first to the firm's assets) and is jointly and severally liable where the partnership is responsible for wrongs suffered by third parties. This is to be distinguished from a limited partnership—see paras 3-13 et seq. below. Although, as a matter of procedure, it can sue and be sued in the partnership name, a general partnership is not a legal entity separate from its individual partners under English law.

Rest of Europe

3-10 Partnership is a recognised legal relationship throughout Europe, founded on contract. Whilst the essential ingredients are generally similar, the particular legal requirements and consequences of partnership will depend upon the relevant jurisdiction. Some continental European jurisdictions distinguish between civil partnerships (often applicable to land-based businesses such as farming or building development) and commercial partnerships where the business involves recognised commercial activities. General commercial partnerships exist throughout Europe. Their individual legal features will, of course, depend upon the relevant national law. Some European examples include:

France:	*société en nom collectif (SNC)*
Germany:	*offene Handelsgesellschaft (OHG)*
Italy:	*società in nome collettivo (SNC)*
Netherlands:	*vennootschap onder firma (VOF)*
Spain:	*sociedad colectiva (SC)*

Illustrations of the partnership route being used for joint ventures between corporate entities include the following cases considered by the European Commission:

- *BP/Mobil.* The two parent companies agreed to combine their respective fuels and lubricants businesses throughout Europe by means of partnerships (or their local equivalent) in each national jurisdiction. Two separate national partnerships would be established in each case. For fuels, BP would hold 70 per cent and Mobil 30 per cent interests, while for lubricants Mobil would hold 51 per cent and BP 49 per cent. [1996 Case IV/M.727]
- *Corning/BICC.* Corning (of the US) formed in 1981 a long-standing 50:50 joint venture in the UK with BICC which took the form of a general partnership, named Optical Fibres, whose principal purpose was the manufacture and sale of optical fibres. Other similar joint ventures with other European partners were formed in France and Germany. [[1986] O.J. L236/30]

[10] *Keith Spicer Ltd v Mansell* [1970] 1 All E.R. 462. The parties agreed to form a limited company together to carry on a restaurant business. Before incorporation one party ordered goods for use by

Particular issues

For a detailed analysis of partnership law in the UK, reference should be made to specialist textbooks on partnership law.[11] No special statutory provisions govern partnerships whose members are companies. The Partnership Act 1890 will apply in the normal way (save to the extent that its provisions are properly excluded by agreement). Many of the issues which arise in structuring a partnership between corporate partners are essentially the same as those for a corporate joint venture. Specific issues or factors which should be considered in relation to a partnership structure for a joint venture under English law include the following: 3-11

PARTNERSHIPS: KEY ISSUES FOR JOINT VENTURES

(1) *Is it a partnership?* This is often a first question, particularly where the parties do not document the arrangement as a conventional partnership. This will particularly apply if there are any elements of profit sharing. The test under English law has been discussed earlier (see para.3-14).

(2) *Liability.* Each partner is an agent of the firm and can bind the firm in the usual course of business. Each partner is jointly liable in law with the other partners for any obligations or liabilities incurred in the course of the partnership (unless the other partner acts without actual authority and the person with whom he is dealing is aware of that). A corporate partner's unlimited liability for the debts and obligations of the partnership can be mitigated to a significant extent by interposing a special purpose subsidiary, as a limited liability company, to act as the partner in the partnership. This will therefore provide an indirect shield of limited liability at a secondary level but will not affect that company's primary unlimited liability as a partner.

(3) *Credit risk.* An important consequence of (2) is that each partner in a general partnership takes a credit risk in relation to the other partner(s)—a risk that the other partner will not ultimately pay (or be able to pay) its share of partnership liabilities and losses.

(4) *Management.* The arrangements for management will depend on contractual agreement. There is a "default" rule that each partner will have a right to participate in management unless otherwise provided—so, in a joint venture context, it is vital that the agreement deals specifically with the management structure in order to avoid uncertainty and potential conflict.

(5) *Profits/losses.* The agreement should clearly set out the rules for division of any profit and the bearing of any losses. Unless otherwise agreed, the "default" rule is that both profits and losses will be divisible equally. The agreement should also make it clear when a contribution may be called from a partner to fund any loss.

(6) *Tax.* If a partnership is created, tax implications will need careful analysis. Sometimes, of course, tax will itself be the driving force behind the creation of a partnership by reason of a partnership's "transparency" for tax purposes compared with a corporate venture.

(7) *Implied terms.* The partnership medium leads, at least under English law, to a number of other terms being implied, inter alia, under s.24 of the Partnership Act 1890 into the

CHAPTER 2

PLANNING THE JOINT VENTURE TRANSACTION

The business strategy to form a joint venture or alliance will be decided by the client. This strategy must be turned into legal form. For the lawyers, the formation of a joint venture or alliance is a transaction which requires planning, process management, third party consents and settlement of a range of different issues. The lawyers are important members of the project team. The aim of this chapter is to outline the issues likely to affect the overall legal planning of the transaction.

Role of the lawyers

2-01 The lawyers play an important part at the planning stage of many ventures. The role of the lawyers will normally be to support and advise the business client with their principal responsibilities being:

(a) to alert the business negotiators to important legal issues to be addressed in establishing the venture and the options available to deal with these issues;
(b) to help structure the joint venture in the light of the business objectives and the interests of the client;
(c) to carry out any necessary "due diligence" and other legal investigations;
(d) to help in identifying, and obtaining, necessary third party clearances and consents;
(e) to ensure that the joint venture arrangements are properly and clearly documented and that the interests of the client are appropriately safeguarded;
(f) to manage the legal and other formal steps necessary to establish the joint venture; and
(g) generally, to advise constructively in helping to establish the joint venture or alliance in accordance with the client's wishes and interests.

Each joint venture and alliance is different. Some are relatively straightforward; others take a considerable time to crystallise and involve a wide range of issues. These transactions involve not only corporate, partnership and contract laws but also the application of other relevant branches of law such as competition, regulatory, intellectual property and employment laws. Qualities of patience, good organisation and a willingness to appreciate differing viewpoints and cultures in reaching consensus will frequently be as relevant as pure legal skills.

"Big picture" issues

of its formation. An outline "road map" can then be established. Key questions to be addressed at this initial "big picture" stage include:

(1) *Commercial objectives.* What are the primary commercial objectives of the client?
(2) *Profit sharing.* Is it intended to be an "equity" joint venture in which profits and losses will be shared—or a non-equity collaboration?
(3) *Contributions.* What initial contributions are being made by the parties into the venture? Money, assets, intellectual property, services?
(4) *Territory and scope.* Is the venture confined to a particular territory or technical field?
(5) *Commercial return.* How does the client expect to make a commercial return from the venture—dividends, payments under ancillary contracts, non-cash benefits or capital gain on exit?
(6) *Key client interests.* What are the key interests of the client to protect—such as control, exit routes, intellectual property rights, dividend return or entitlement to product output?
(7) *Governance and control.* What rights of management control or participation does the client expect or need (including from a regulatory perspective)?
(8) *Non-compete.* Will there be non-compete or exclusivity restrictions on the parties?
(9) *Exit strategy.* Is the client likely to be a long or short-term participant? What features are key to an exit strategy or need protection in the event of termination?
(10) *Third party consents.* What material consents, regulatory approvals, licences must be obtained or other conditions precedent satisfied before the joint venture or alliance can commence?

More detailed Joint Venture Checklists of issues to be considered in planning a joint venture are set out in Part F of this book

INITIAL TRANSACTION PLANNING

Transaction "road map"

The course of each joint venture or alliance will be different. The lawyers should plan at an early stage a broad "road map" setting out the key legal steps, including the principal issues requiring resolution or action for the particular venture and a target timetable. Tasks likely to affect the timetable include particularly: 2-03

(a) undertaking any due diligence exercise;
(b) legal and tax structuring of the joint venture;
(c) negotiation of key commercial issues;
(d) valuation of each party's contribution;
(e) applying for relevant third party consents and, in particular, regulatory approvals.

Identification of tasks which involve a lengthy lead time before the agreements can be concluded is an important part of the transaction planning process. Establish-

In complex joint ventures, it is often useful to maintain an action list, or status report, as a continuing document in order to keep all parties informed and to ensure that an overall perspective of progress is maintained. For instance, in the case of an equity joint venture designed to combine the existing businesses of two or more parties into a UK joint venture company ("JVC"), such an action list or transaction "road map" could comprise the following:

PROJECT X: LEGAL "ROAD MAP"

Action [Add columns for: Primary Responsibility; Target Date; Status]

1. Initial documents

- Confidentiality agreement/information exchange agreement
- Memorandum of understanding (MoU)

2. Structure/commercial issues

- Identify activities and companies to be contributed by each party. Decide basis for valuation
- Decide proposed proportions of equity shares in JVC for each party
- Decide (if necessary) method of "equalising" any initial difference in valuation (if 50:50 equity shares)
- Agree form of any financial audit/review to be undertaken
- Decide legal form of joint venture (e.g. joint venture company ("JVC"))
- Decide location of JVC and any supporting tax structure (e.g. "income access" shares)
- Decide legal method of merger (e.g. transfer of subsidiaries or assets to JVC)
- Decide principal features of management structure, including:
  - — role of board
  - — representation/quorum/casting vote
  - — matters to be reserved to shareholders
  - — authority to be given to management
- Establish likely accounting treatment of JVC in accounts of parents
- Decide capital structure and debt/equity ratio for JVC
- Decide amount of issued share capital of JVC
- Decide amount and form of any loan capital to be provided to JVC (and any ongoing funding commitments of parents)
- Establish whether common accounting principles for JVC need to be agreed
- Decide name of JVC
- Identify entities to participate in JVC as shareholders. Need for parent company guarantees?
- Identify matters which are conditions precedent to establishment of JVC and likely timetable for approvals (see also s.5 below)
- Agree preliminary announcement/press release

3. Due diligence

- Financial/commercial/tax due diligence to be undertaken
- Technical/engineering due diligence to be undertaken
- Legal due diligence to be undertaken (including anti-bribery and corruption)

4. Reorganisations/preparation

- Establish steps required for any preliminary reorganisation by each party of business or subsidiaries to be contributed to JVC
- Contracts and other assets: identify any third party consents required for transfers of material assets or contracts (including change of control provisions); review effect on any borrowing covenants
- Properties: identify and establish arrangements for transfer or lease of properties to relevant subsidiaries
- Intellectual property/IT: identify and establish any need for formal transfers or licences of IPR (including use of trade marks and names) or IT systems
- Associated undertakings: identify subsidiaries and interests in other companies or joint ventures to be contributed to JVC
- Employees: identify and arrange transfers of employees to JVC or relevant subsidiaries to be contributed to JVC
- Pensions: establish pension position and proposals for ongoing arrangements
- Share options: establish effect on any existing parent company share options for relevant employees
- Guarantees/indemnities: identify any guarantees or indemnities given by parents which are to be replaced
- Support arrangements: identify any need for, and terms of, any ongoing support agreements between each parent and JVC or relevant subsidiaries, covering e.g.:
  - — site support facilities
  - — shared computer or IT systems
  - — administrative services
- Agree intra-group transfer documents to effect preliminary reorganisation(s)

5. Regulatory approvals and other third party consents

- Identify all required notifications to, or clearances required under, competition or other regulatory authorities including where relevant:
  - — European Commission under EC Merger Regulation
  - — Competition and Markets Authority under Enterprise Act 2002
  - — regulatory authorities in other relevant countries
- Any consents required from any relevant industry licensing authority?
- Identify consents required (commercially or legally) from major customers and/or suppliers
- Identify material tax clearances required
- Establish need for any consents from lenders under any financing documents
- Identify need to consult with, or obtain any consents from, employees or works councils
- Establish whether any consents or notification requirements apply in relation to shareholders or any relevant stock exchange (e.g. shareholder consent for Class 1 transactions under the Listing Rules of the UK Listing Authority)

6. Settle principal legal documentation (in draft)

- *Intra-Group Transfer Agreements* and ancillary agreements relating to preliminary reorganisations
- *Framework or Contribution Agreement* covering inter alia:

- — contribution of relevant companies and/or appropriate businesses to JVC
- — warranties and indemnities
- — valuation/audit procedures
- — conditions precedent
- — conduct prior to Closing
- *Shareholders' Agreement* covering inter alia:
  - — board representation
  - — reserved matters for parent shareholders
  - — future funding
  - — dividend policy
  - — non-compete
  - — transfer restrictions
  - — dispute resolution
  - — termination/break-up
- Articles of association of JVC
- Administrative services agreements between parties and JVC
- Technology licence agreements/trade mark agreements between parties and JVC
- Business plan

7. Signing

- Board approvals and authorisations confirmed
- Signing of framework/contribution agreement (and exchange of disclosure letters, if applicable, in relation to warranties)
- Approval of agreed form drafts:
  - — shareholders' agreement
  - — JVC's articles of association
  - — administrative services agreements
  - — technology licence agreements/trade mark agreements
  - — business plan
- Announcement/press release

8. Pre-Closing

- Notification to European Commission if required under EC Merger Regulation
- Formation of JVC and adoption of articles of association
- Confirm all fundamental consents and clearances obtained
- Confirm no regulatory action outstanding
- Confirm all other conditions precedent satisfied
- Confirm all necessary board authorisations obtained

9. Closing

- Meeting/resolution of JVC to re-organise capital and adopt new articles of association (unless previously done)
- Transfers of shares by each party to JVC in specified subsidiaries (or execution of business transfer documentation if relevant)

- Signature of:
  - — shareholders' agreement
  - — administrative services agreements
  - — technology licence agreements/trade mark agreements
  - — any other ancillary contracts
- Appointment of members of board of JVC by the parties
- Board meeting of JVC, inter alia, to adopt business plan
- Announcement/press release

10. Post-Closing actions

- Appointment of new directors of relevant subsidiaries
- Post-Closing financial audit/review:
  - — prepare balance sheets
  - — agree any equalisation or post-Closing adjustments
- Filings with UK Registrar of Companies

It will usually be useful to maintain a list of documents required for the legal steps of the transaction. This should include a clear identification of which party (or adviser) is responsible for drafting or producing each particular document. The content will, of course, vary with each transaction. These steps are basically examples of sensible transaction management. Joint ventures and alliances can be complex projects and the lawyers are an important part of the project management team.

Confidentiality agreement

2-04 Parties will have preliminary talks and discussions prior to any joint venture or alliance. Exchange of information will usually be a key feature.[1] Parties should put in place appropriate confidentiality agreements at an early stage before initial technical information, financial data and other details are exchanged in preliminary negotiations. The agreement should cover information which is disclosed either orally or in writing.

Under English law, there are principles whereby a party can claim remedies to assert unauthorised use or disclosure of information imparted "in confidence".[2] Similar principles will apply in many other jurisdictions. However, it is preferable to have the certainty of a contractual obligation of confidentiality in the event that

1 A party seeking (e.g. by an information memorandum) a partner or investor to acquire shares in a joint venture project may, in the UK, need to comply with rules regulating "an invitation or inducement to engage in investment activity" under s.21 of the Financial Services and Markets Act 2000—see further para.7-24, including discussion of relevant exemptions.

2 A key English law case is *Seager v Copydex Ltd* [1967] 1 W.L.R. 923 where the plaintiff disclosed features of an invention to the defendant in the course of negotiations regarding its possible development. Negotiations were aborted. The defendant subsequently produced a product using, albeit unconsciously, part of the information given to it by the plaintiff. The defendant was held to have used confidential information to gain a springboard. The court awarded compensation to the plaintiff. Similarly, in *Coco v AN Clark (Engineers) Ltd* [1969] R.P.C. 41 the court indicated that this principle of confidentiality would apply to information disclosed in joint venture negotiations: "in particular, where information of commercial or industrial value is given on a business like basis, and with some avowed common object in mind, such as a joint venture… I would regard the recipi-

negotiations do break down.[3] Such an agreement also serves the practical purpose of emphasising to each party the confidentiality of the information being handed over and providing an agreed mechanism for the handling and, if necessary, return or destruction of the relevant material. Particularly where technical information is being disclosed, it will generally be wise to keep a specific list of what is disclosed and the persons to whom the information is disclosed.

Typical undertakings which will be sought, usually on a reciprocal basis from each party, include the following:

(a) not to use the information for any purpose other than in connection with the joint venture or alliance;
(b) not to disclose the information to any person except on a "need to know basis" in connection with the venture;
(c) to require each individual to whom the information is disclosed to undertake to keep such information confidential or for the relevant party to be contractually responsible for procuring that the individual does so;
(d) if the negotiations break down, to return all original documents and to return or destroy all copies, secondary notes or information derived from those original documents or copies; and
(e) possibly, to keep the fact of the negotiations themselves confidential until the parties agree on an announcement.

An example of a two-party Information Exchange Agreement is set out as Precedent 1 in Part E

2-05 Even with a confidentiality agreement in place, certain information may be so sensitive that a party requires special protection against potential misuse. Protective measures could include:

(a) restricting access during the due diligence process on a "need to know" basis to a small number of identified senior employees of the other party (preferably after execution of individual confidentiality undertakings);
(b) placing restrictions on copying of sensitive information or removing documents from the due diligence site;
(c) use of an electronic or "virtual" data room with access controlled by protected passwords;
(d) "staggering" the release of information (particularly if the proposed joint venture is with a competitor or potential competitor) so that disclosure of highly sensitive information is not made until the disclosing party is reasonably certain that the venture will proceed;
(e) possibly, making certain confidential information available only to a third party intermediary (such as accountants, lawyers, financial advisers or other specialists) who may be permitted to examine and provide a summary

[3] It is a question of interpretation of the agreement, but generally the agreement will displace the general legal principles developed by case law if the agreement does not expressly preserve them, as the contract will be taken as the parties' agreed way of defining, allocating and restricting their resepctive obligations (*MacDonald, Dickens & Macklin v Costello* [2011] EWCA Civ 930) but a more nuanced approach may sometimes apply: see *CF Partners (UK) LLP v Barclays Bank Plc* [2014] EWHC 3049 (Ch), where the judge said that confidentiality obligations are equitable obligations and that their scope and content are informed, but neither exclusively nor conclusively defined,

confirmation or report to the other party without copying or recording details of the confidential information itself.

If, as is sometimes the case, a party is disclosing information in breach of a duty of confidentiality which it owes to a third party, the disclosing party should consider taking an indemnity from the recipient party against losses suffered by the disclosing party if the breach comes to light (e.g. through an unauthorised disclosure of information by the recipient).[4] Such an indemnity may not easily be achieved, however; some parties adopt an instinctive rejection to any suggestion that they should provide an indemnity.

Due diligence

"Due diligence" and other pre-contract investigations are perhaps even more important in the case of a substantial equity joint venture than in the case of an outright corporate acquisition. Joint ventures entail ongoing relationships. It will prove commercially difficult, in all but the most serious cases, to pursue warranty or other claims against a co-venturer after the commencement of the joint venture relationship; far better to be thorough in due diligence investigations prior to concluding the joint venture. 2-06

The extent and focus of "due diligence" will depend upon the nature of the contribution being made by the other party. The exercise should concentrate on the key assets of the other party which are required to achieve the business objectives of the client, e.g.: technology/IPR; client/customer base; suppliers; brand names; land/buildings/facilities; major existing contracts; personnel; regulatory licences. Where it is a distinct business which is being contributed by the other party to an equity joint venture, then the "due diligence" exercise will be comparable to that for a corporate acquisition. A wide range of issues may need to be investigated by the client or its professional team. Separate (but co-ordinated) investigations may include:

(a) *reputational risk*: due diligence concerning the risks posed by engaging in the relationship with the co-venturer (e.g. bribery and reputational risk as considered in para.2-08 below);
(b) *commercial*: investigating all relevant commercial aspects of the business being contributed: products, markets, distribution, suppliers, risk management, IT etc.;
(c) *financial*: including a review of current management accounts relating to the business to be contributed; profitability of any major contracts being brought into the venture; identifying all relevant intra-group management and similar charges or cost allocations; assessing any material differences in accounting policies between the parties;
(d) *legal*: including investigation of:
— title to key assets and properties (including identifying any material encumbrances);

[4] It is sometimes assumed that, if a person has agreed to keep information confidential and wishes to disclose the information to a third party, it is implicit that there will be no breach of confidentiality as long as the end-recipient is also under a duty of confidentiality, so that there is a chain of undertakings between the owner of the information and the ultimate recipient. According to the High Court in *Richmond Pharmacology Ltd v Chester Overseas Ltd* [2014] EWHC 2692 (Ch), this is misconceived; the confidentiality obligation was held to mean exactly what it said, and there was

— material contracts (including identifying contracts where any third party consent is required to transfer the benefit of the contract into the venture or the third party is entitled to trigger a right of termination upon a "change of control");
— litigation or claims involving the assets or business being contributed (including infringement actions or any product liability claims);
— regulatory licences held (including actual or potential claims of regulatory non-compliance or any regulatory investigations);
— anti-bribery and corruption compliance, policies and procedures;
— identifying any other liabilities, claims, commitments or laws which reduce the value or use of key assets being contributed;

(e) *technology*: evaluation of the technology assets; material IP/IT licences "in" and "out"; registration or protection policy for new know-how, patents and brand names; research and development facilities; infringement claims (past and current); cybersecurity practices and capabilities[5];
(f) *land/buildings/facilities*: examining the physical condition of the site and key production equipment and facilities; development plans; planning conditions and constraints;
(g) *environmental/health and safety*: investigating compliance with environmental and health and safety legislation (including potential liabilities or compliance costs faced by the business);
(h) *employees/personnel benefits*: reviewing key personnel contracts; remuneration and benefits packages; funding of pension schemes; labour agreements; comparison of the parties' respective arrangements with employees generally;
(i) *tax*: reviewing tax status; tax returns; any disputes with tax authorities; potential tax charges within the joint venture.

The approach to "legal" due diligence should be developed with the client—and with the other party where each is contributing substantial assets. Care should be taken to dovetail with, and not duplicate, other investigations being undertaken by the client and/or other specialists.

An example of an outline Legal Due Diligence Questionnaire for an equity joint venture is included as Precedent 3 in Part E

2-07 The "due diligence" exercise will need to be adapted to the circumstances of the venture—and the relationship which may already exist between the parties. A full exercise of this kind, for instance, will often not be appropriate for a start-up joint venture or a short-term collaboration. The way due diligence is handled may also be less aggressive in style than a corresponding exercise prior to an acquisition. Whilst warranties and indemnities may be negotiated in the agreements, prior awareness and knowledge is nevertheless by far the preferable objective before entering into a substantial joint venture. "Due diligence" is an important stage in the preparation for a venture.

5 A 2016 survey by PwC found a significant increase in detected information security incidents and highlighted the risk of attack when one infiltrated IT system was integrated with another company's

Information exchange during the negotiation stage can be a significant problem.[6] If a party does not want to share commercially sensitive information at the early stage of a negotiation (or if there are legal restraints), consider using the services of independent financial and legal advisers who can offer "clean team" due diligence–collecting information from both parties to produce an independent report that does not include matters such as valuations or that can black-out certain contract details to help both parties make an early assessment of the merits of the proposed venture.

It is more satisfactory and usual, at least in the UK, for due diligence to be undertaken prior to signing a binding joint venture agreement. In some situations, where it is impracticable to obtain all necessary information prior to commitment, it may be agreed that due diligence—perhaps in defined areas—can be undertaken between signing of the initial contract and completion, with a satisfactory outcome of due diligence by the relevant part(ies) being a condition precedent of completion. This leaves significant uncertainty but may be the only practical route in some circumstances.

Anti-bribery and corruption

A material risk for a party joining forces with a partner in a new joint venture or alliance is the reputational damage which can potentially flow from misdeeds of that partner or the joint venture itself. Now, with the passing of the Bribery Act 2010, severe legal consequences can also follow in the UK if those misdeeds include bribery or corruption.[7] Measures to safeguard against the risk of bribery (and prosecution for bribery) will be important factors at the planning stage of any joint venture—particularly a joint venture with a new partner. 2-08

BRIBERY ACT: APPLICATION TO JOINT VENTURES (1) *Offences*. The main features of the Act are the creation of four offences: — two general offences of (i) offering, promising or paying a bribe to another person (active); and (ii) requesting, receiving or agreeing to accept a bribe (passive); — a discrete offence of bribing a foreign public official; and — a new "corporate offence" of failure by a commercial organisation to prevent bribery by any person performing services on its behalf (an "associated person") anywhere in the world, unless the commercial organisation can demonstrate that it had put in place "adequate procedures" designed to prevent bribery.

6 In the IESE/KPMG study in 2009, over one-half of the respondents believed that their partner did not provide sufficient information on their financials, forecasts and costs.
7 The Act has teeth. In the first reported conviction (February 2016) under the new "corporate offence" under the Act, Sweett Group, a listed quantity surveyor, was ordered to pay £1.4m (plus a