Preface

Although everyone will agree that a joint venture is organized to create synergies that are unavailable to joint venture partners individually, very few people try to define synergies seriously. It seems that most people vaguely think of synergies as an increased social welfare by partnering. It is, however, not the case for joint ventures. A joint venture is a strategic alliance between two or more business companies. A business company will never participate in a joint venture to improve public welfare, but only for maximizing its own payoff (as a result, public welfare will be improved).

This book defines synergies as total return for each partner. The total return is comprised of three types of payoffs, i.e., return on investment, return from transactions, and ancillary return. This definition is not only realistic from a practitioner's point of view, but also makes it possible to analyze incentive bargaining in a joint venture from a game-theoretic point of view. In a successful joint venture, each partner is satisfied with its total return. If a partner is dissatisfied with its total return, its incentive to provide its monetary and human capital to the joint project will be lost. As a result, the other partner will not obtain sufficient synergies in the long run. Partners will bargain with each other for maximizing their own payoff.

A joint venture is a risky project, almost always with in-built conflicting interests. Partners predict opportunistic behavior of the other partner and easily lose their incentive to cooperate. Many joint ventures fail, not necessarily because of operational management failure, but because of organizational management failure, i.e., incentive bargaining failure.

Partners will confront various tradeoffs in incentive bargaining. Therefore, the key point of successful bargaining strategies is to maintain a good balance between partners' incentives. Partners can more easily reach a good balance by taking complementarities into consideration. For example, a partner may be satisfied with less control but greater return. Another partner may be satisfied with less monetary return but more ancillary return, such as a learning effect.

Joint venture is a typical long-term relational contract. Incentive bargaining in joint ventures is not a one-shot game but a staged

bargaining, the pattern of which will change depending on the stage of the joint venture lifecycle. Typically, when a cost-center joint venture turns into a profit-center joint venture, two-player bargaining between the JV partners will be changed into three-player bargaining including management of the joint venture.

The pursuit of synergies in joint ventures will inevitably raise various legal issues, particularly intellectual property law, antitrust law, and corporate law. This book will cover critical legal issues of joint ventures. Legal analysis is basically premised on U.S. law (Delaware corporate law in particular) with occasional references to Japanese law.

This book is actually the result of a "joint venture" among a scholar and two practitioners. Zenichi Shishido has studied joint ventures from a law and economics point of view. Munetaka Fukuda and Masato Umetani have worked for the legal departments of two different international joint ventures, and have not only created and monitored many joint ventures, but have also solved their disputes. We have got together and discussed these issues on a monthly basis for the last 15 years and have finally reached a shared view on joint ventures. As a result, this book is based on Shishido's theoretical framework with rich details in practice provided by Fukuda and Umetani. Our study is based on many real cases both experienced by Fukuda and Umetani, and publicized by the media. This book has a list of joint venture cases reported by NIKKEI newspaper for the last 15 years as an appendix.

Although this book shares the basic analytical framework of our previous book published in Japanese (Zenichi Shishido, Munetaka Fukuda & Masato Umetani, Jointo Bencha Senryaku Taizen: Sekkei, Kosho, Homu No Subete [Joint Venture Strategy: Design, Bargaining, Law] (Toyokeizai, 2013)), all chapters are reconstructed and rewritten for international readers.

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Zenichi Shishido, Munetaka Fukuda, Masato Umetani

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Effective strategies for maintaining a meaningful threat of exit include licensing intellectual property to the joint venture instead of transferring, or structuring the joint venture so that it is dependent on the continuous provision of human capital. Conversely, for partners that do not possess indispensable human capital, retaining a contractual right to withdraw financial capital is extremely important from the standpoint of sharing control. Even if a partner cannot meaningfully threaten to withdraw human capital, the threat of withdrawing monetary capital plays a counterbalancing role.

4. Bargaining over sharing total return

4.1 THREE TYPES OF RETURN

The purpose of bargaining over sharing total return is to maximize synergies realized by each JV partner. Such synergies include three types of return: return on investment, return from transactions, and ancillary return. Whichever form the return from a joint venture takes, the joint venture is a success if the sum total of the three types of return is maximized for each partner and exceeds initially planned return. Bargaining over sharing of total return is the process of setting rules for sharing the three types of return between partners.

In bargaining over sharing total return, partners first determine return on investment. Return on investment takes the form of profits derived from the joint venture and is shared in proportion to the partners' respective ownership percentages. As such, it is generally not susceptible to disagreements during incentive bargaining.[1] Partners can determine return on investment through a comparative analysis of the possible courses of action: (1) unilateral market entry, (2) market entry through a joint venture, and (3) forgoing market entry completely. Next, they should design an incentive framework and utilize return from transactions to rectify any imbalances.[2] Lastly, individual partners should identify opportunities for capturing private gains, or ancillary return, from participation in the joint venture. If they follow this process, they should be able to rationally justify their decision to establish a joint venture to their shareholders and stakeholders (e.g., creditors, suppliers). As part of this process, the partners should make sure that they quantify synergies net of the transaction costs associated with forming the joint venture.

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[1] *See* IAN HEWITT, HEWITT ON JOINT VENTURES, at Ch. 7-13–14 (5th ed. 2011).

[2] On imbalances, *see* Ch. 2, 2.1.

4.2 RETURN ON INVESTMENT

4.2.1 Definition of Return on Investment

Return on investment refers to the sum total of dividends and capital gains that shareholders receive based on their respective ownership percentages in a JV company. As a general rule, return on investment is shared in proportion to the partners' ownership percentages.[3]

4.2.2 Bargaining over Sharing Return on Investment

To increase return on investment, JV partners must "maximize the size of the pie" by increasing the joint venture's net present value. Inter-partner bargaining over return on investment is a non-zero-sum game.

In bargaining over sharing return on investment, it is important to first agree on how to allocate the cash flows that factor into return on investment. Some JV partners place priority on long-term growth in enterprise value fueled by internal retention and reinvestment of profits. Others place priority on short-term cash dividends to recoup their investment in the joint venture as early as possible.

Such different priorities give rise to conflicting interests between partners. Joint venture agreements or business plans appurtenant thereto often include provisions on dividend policies (e.g., dividend payout ratio), compulsory accumulation of capital reserves, and other restrictions on the use of profits (e.g., internal retention of profits within the joint venture through dividend limits, investments in designated objectives, prioritized repayment of borrowings). Dividend policies should be reviewed in light of the joint venture's profitability and are subject to renegotiation.[4]

Second, once ownership percentages (partners' shares of return on investment) have been set, they are difficult to change. This difficulty is due to restrictions in corporate law and joint venture agreements that lock in the JV partners and maintain constant ownership percentages, such as

[3] Under both Japanese and US corporate law, returns on investment can also be shared disproportionately to percentage ownership interests. In Japan, for example, the Companies Act grants flexibility in sharing returns among partners when different classes of shares are used (Article 108) or when a joint venture is organized as an LLC (Articles 575–675). However, sharing returns in disproportion to ownership percentages can raise tax issues.

[4] *See* Hewitt, *supra* note 1, at Ch. 9-20.

stock transferability restrictions and pre-emptive rights granted to shareholders. If a joint venture is organized as a stock corporation, its owners cannot get their equity capital contributions back until the joint venture is dissolved.

A key concern for JV partners is whether the other partner(s) will contribute resources necessary for the joint venture's growth once it is up and running. One way to incentivize the other partner to provide human capital indispensable to the joint venture is to grant the other partner a share of profits in excess of its ownership percentage. Methods of doing so include issuing dividend-paying preferred stock and organizing the joint venture as an LLC. When joint ventures are organized as a stock corporation, however, the partners' respective shares of return on investment tend to equal their respective ownership percentages. In such cases, a more practical way to incentivize the other partner by disproportionately sharing total return is to adjust the other partner's share of return from transactions instead of its return on investment.

In establishing a joint venture, partners draft joint venture agreements that include provisions on their rights and duties to contribute additional monetary capital. In some cases, however, one partner lacks the wherewithal to contribute additional capital.[5] Partners are typically granted the right to veto capital increases,[6] but the risk of missing out on business opportunities is difficult to avert.

Unless a joint venture is a publicly traded company, JV partners have limited means of recouping their invested capital because their joint venture's stock is not salable in a public equity market. The ultimate means by which a partner can realize its share of return on investment is to sell its ownership interest to the other partner or a third party through a bilateral transaction or, if the joint venture is dissolved and liquidated, to collect its share of the residual assets distributed to shareholders after all creditors have been paid off in full. The ways in which partners may exit a joint venture and valuation of their ownership interests are issues related to exit bargaining, discussed in Chapter 5.

[5] In the case of venture capital investment, contractual provisions are drafted on the assumption that ownership percentages will change with each successive growth round. With joint ventures, however, ownership percentages are generally assumed to remain constant.

[6] *See* Hewitt, *supra* note 1, at Ch. 9-10; Ch. 9-16.

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4.3 RETURN FROM TRANSACTIONS

4.3.1 Definition of Return from Transactions

Return from transactions is contractual return that a partner directly receives from goods, services, and/or rights transactions between itself and the joint venture. Transactions between joint ventures and their parent companies are generally planned before the joint venture is established. Return that a JV partner earns from such transactions is separate from and additional to return on investment. Transaction contracts between joint ventures and their parent companies are an important determinant of the viability of the joint venture's business model and the partners' total return.[7] Return from transactions is return available to partners by virtue of their participation in a joint venture. They are an incentivizing tool and subject to both contractual bargaining and monitoring.

If a joint venture requires non-substitutable management resources possessed by one of its parent companies, operation of the joint venture's business as originally planned is contingent on the parent company providing those resources to the joint venture. Conversely, if management resources required by a joint venture are highly substitutable, the joint venture can procure equivalent goods or services from a third party in the marketplace instead of from its parent companies.

If a joint venture and one of its parent companies conduct transactions on arm's-length terms (with respect to, e.g., price, quantity, time frame), both the cost to the joint venture and the profit earned by the parent company will be the same as if the transactions had been conducted with a third party instead of between related parties.[8]

Nonetheless, the ability to stably conduct transactions within the same group, even on arm's-length terms, is beneficial to the transacting partner. Also note that, as used herein, return from transactions does not mean a transfer of the joint venture's property to one JV partner at the expense of the other partner(s) through transactions more advantageous to the transacting partner than an arm's-length transaction.

[7] *See id.*, at Ch. 6.

[8] In effect, the company does not incur any detriment as a result of transactions that generate such returns, but the transactions formally meet the criteria for self-dealing transactions and therefore require both JV partners' consent and are subject to monitoring by the partners as to whether they are necessary, their terms are customary, and they are priced at arm's length.

Finally, if a joint venture is operated as a cost-center, the JV partners will generally seek to earn return from transactions instead of return in the form of dividend distributions.[9]

4.3.2 Considerations in Structuring Return from Transactions

When structuring return from transactions, JV partners should take the following into consideration:

(i) division of their roles and responsibilities within the joint venture (e.g., identify synergies realizable through mutually complementary competitive advantages, such as division of production/development and marketing functions between the partners);
(ii) business model and its legal structure (compare with other available legal means to achieve the same economic objectives and decide, for example, between earning a 3 percent royalty on products manufactured and sold by the joint venture or a 5 percent operating margin on products manufactured by the partners themselves and sold to the joint venture);
(iii) economic advantages and disadvantages of related-party transactions in comparison to third-party transactions;
(iv) the need for exclusive rights (e.g., exclusive distribution rights, exclusive drawing rights); and
(v) determination of transaction consideration such as goods prices, service fees, and intellectual property licensing royalties[10] (e.g., decide on a fixed-markup cost-plus pricing formula for goods). In the course of a joint venture's actual operations, even formally arm's-length transactions sometimes end up distributing return from transactions to one JV partner. Partners therefore typically have the right to approve material transactions between the joint venture and the other partner, as well as the terms thereof.

4.3.3 Pro rata Self-Dealing Transactions

Transactions from which JV partners derive return could be pro rata self-dealing transactions or non-pro rata self-dealing transactions, the

[9] In joint ventures treated as a cost-center, product sales prices (or service fees) charged by the joint venture to its parent companies are typically set by a cost-plus formula, whereby the joint venture earns a fixed markup on the sum of its raw material and processing costs. On cost-center joint venture, *see* Ch. 11.

[10] *See* Hewitt *supra* note 1, at Ch. 6-38; Ch. 6-39.

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latter of which aim to rectify imbalances. Return from pro rata self-dealing transactions is distributed to partners in proportion to their respective ownership percentages. To the extent possible, partners should conduct transactions with their joint ventures on a pro rata basis to ensure that they receive their fair share of return in relation to the other partner(s).

If both partners contribute non-substitutable management resources essential to realization of mutual synergies and they elect to individually enter into transaction agreements with the joint venture as a means of contributing such resources, the transactions are specific to the joint venture and therefore not substitutable with third-party contractual arrangements. When both partners engage in this type of transaction with their joint venture, return from the transactions is generally shared on a pro rata basis to equitably share total return relative to the partners' respective total contributions of both monetary and human capital.

Pro rata self-dealing transactions are a method of distributing de facto return to partners based on an agreement by the partners entered into before the joint venture's operating profitability is known for certain. Such transactions therefore pose a risk of creating inequities among partners if, for example, actual transaction volumes differ from forecasted volumes. Another potential concern is that return from pro rata self-dealing transactions is essentially equivalent to hidden dividends if the transactions' pricing inordinately detracts from the joint venture's profits. In such cases, return from pro rata self-dealing transactions is at risk of being taxed as a gift or gratuity or subject to transfer pricing taxation.[11]

The classic case in which pro rata self-dealing transactions succeed is where a joint venture and its parent companies have a vertical relationship with each other within a product value chain and the joint venture is able to transact equally with all of its parent companies. One hypothetical example is a 50:50 joint venture that manufactures and supplies equal quantities of a product to both of its parent companies at the same price and on the same schedule. In practice, however, pro rata self-dealing transactions are difficult to realize because of variability of prices or sales volumes caused by factors such as market changes or intensification of competition. Thus, the failure to effect a pro rata self-dealing transaction is often caused by an unintentional distribution to one JV partner of a disproportionately large share of return from transactions.

[11] For example, transactions in which both JV partners earn management service fees in proportion to their ownership percentages in exchange for management know-how provided to the joint venture pose relatively high taxation risk despite being pro-rata self-dealing transactions.

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4.3.4 Return from Non-Pro rata Self-Dealing Transactions

The second type of return from transactions is not proportional to JV partners' ownership percentages. Only the partner that engages in the transaction, subject to the consent of the other partner(s), is entitled to such non-pro rata return from the joint venture.[12]

Because JV partners' shares of contributed human capital never coincide with their ownership percentages, sharing of total return in proportion to ownership percentages results in an inequitable division of total return between partners.[13] Imbalances arise between partners' human capital contributions and their ownership stakes in the joint venture as a result of each partner providing different human capital in accord with the joint venture's objective of pooling management resources to compensate for each individual partner's resource deficiencies.

If not rectified, such imbalances act as a disincentive against human capital contributions by the disadvantaged partner. The partner with the most human capital to contribute must be incentivized to contribute its resources by being entitled to earn total return in proportion to its outsized capital contribution. For example, a JV partner that contributes human capital in the form of a patent licensed to the joint venture typically receives royalties plus all profits from the grant-back of any invention patent granted to the joint venture that is directly related to the licensed technology. In comparison to return earned by its co-partner(s), the licensor partner exclusively earns the return attributable to the human capital it contributed in disproportion to its ownership interest. The terms of such transactions are freely negotiable between the partners in theory. In actuality, however, they are constrained by tax law. Transaction terms consequently must be set within an arm's-length price range.

To the extent that one partner receives a larger share of return from transactions than the other partner(s), total return from the joint venture is shared unequally, as are opportunities to benefit from joint venture synergies. Accordingly, if only one partner conducts transactions with the joint venture, it must first obtain the consent of the other partner, even if the transactions are made at arm's length. The other partner must bargain from the standpoint of total benefits (i.e., including other types of return) to realize a share of total return proportionate to their shares of

[12] If one JV partner and a joint venture engage in transactions that increase the joint venture's assets as a result of the partner agreeing to transaction terms disadvantageous to itself, the transactions would have the character of an additional equity capital contribution by the partner to nurture the joint venture.
[13] *See supra* Ch. 2, 2.1. *See* also Hewitt, *supra* note 1, Ch. 2-36.

contributed monetary and human capital. Doing so requires complex business planning regarding rules for sharing prospective unrealized return.

4.3.5 Specific Examples of Return from Transactions

Methods of realizing return from transactions include transfers of monetary consideration from the joint venture to partners in the form of markups (transfer price minus cost of goods sold) in goods supply contracts, royalties based on intellectual property licensing agreements,[14] service fees in outsourcing agreements related to the provision of services (e.g., manufacturing, sales, administrative) to the joint venture,[15] interest payable on loans,[16] rent payable on leased real estate, remuneration of officers appointed to the joint venture by partners, and management fees.[17]

4.3.6 Monitoring

In terms of sharing return from transactions, JV partners may evade the other partner's oversight and engage in opportunistic behavior with the aim of earning more than their agreed-upon share of total return (i.e., capturing return from transactions to which they are not rightfully entitled). To prevent such opportunism, a partner should monitor the other partner's transactions with the joint venture and must be able to exercise veto rights. In the particular case of transactions intended to rectify imbalances, a partner must monitor transaction agreements between the other partner and the joint venture and sharing of return from transactions.

However, when conducting transactions with the joint venture, one partner may deal with a director that it appointed to the joint venture and conceal the nature of the transactions from the other partner(s). A formal resolution by the joint venture's board of directors consequently may not

[14] *See* Hewitt *supra* note 1, at Ch. 17.

[15] *See id*, at Ch. 6-42.

[16] *See id*, at Ch. 7-20.

[17] On Management Agreements, *see id.*, at Ch. 6-36. For example, in cases in which a joint venture is managed by personnel assigned to the joint venture by its parent companies, the joint venture is sometimes charged management fees calculated by each parent company as the personnel's compensation for full-time employment (including a cost-plus markup) multiplied by the percentage of time the personnel spend working at the joint venture.

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be an effective monitoring mechanism. It is therefore important for a partner to impose a duty of advance notification on the joint venture and secure a right to information disclosure and right of prior approval of the joint venture's material transactions with the other partner.

Key points that a partner should look into when monitoring the other partner for opportunistic or duplicitous behavior with respect to return from transactions include the following:

(i) Are the transactions reasonably necessary for the joint venture? For example, is the joint venture paying the other partner royalties derived from an unneeded patent on an obsolete technology?
(ii) Is any partner engaging in surreptitious self-dealing transactions not sanctioned by the joint venture's board of directors?
(iii) Is the joint venture fulfilling its notification duties to the partners? Is information being adequately provided to the joint venture's board of directors?
(iv) Is any partner in breach of contract? For example, is any partner appropriating an unduly large share of resources to itself in violation of a pro rata sharing agreement or, in the case of a cost-plus pricing agreement, improperly manipulating costs while ostensibly abiding by the agreed-upon markup?
(v) Is pricing reasonable and economically rational?

4.3.7 Stakeholder and Tax Issues Related to Return from Transactions

Sharing return from transactions to rectify imbalances entails a number of risks, including (1) the risk of self-dealing,[18] (2) taxation risks,[19] and (3) the risk of antitrust violations.[20] Figure 4.1 shows the web of

[18] On conflicts of interest, *see id.*, at Ch. 6-13; Ch. 8-57; Ch. 8-60.

[19] *See id.*, at Ch. 15.

[20] *See id*, at Ch. 16. Federal Trade Commission and U.S. Department of Justice, *Antitrust Guidelines for Collaborations among Competitors* (April, 2000) www.ftc.gov/os/2000/04/ ftcdojguidelines.pdf; *Horizontal Merger Guidelines* (August, 2010) www.justice.gov/ atr/public/guidelines/hmg-2010.pdf. *See* Section 1 of the US Sherman Act (prohibition against contracts, combinations and conspiracies in restraint of trade or commerce) and Article 101 of the Treaty on the Functioning of the European Union (prohibition against agreements and concerted practices restrictive of competition). If a joint venture is a full-function joint venture possessing all functions of an autonomous business entity on a long-term basis, the EU Merger Regulation and Horizontal Merger Guideline

Sixth, a company can obscure its identity by partnering with one or more other companies (e.g., a joint venture can enable a company to expand into a foreign country in which trade frictions exist or, in Japan, enable a company that belongs to a large corporate group, a so-called *keiretsu*, to transact business with unaffiliated companies).

Nevertheless, it is not always more advantageous to establish a separate legal entity for the joint venture than to enter into a contractual business alliance. The obvious advantages of a contractual alliance include expeditiousness and ease of exit.

7. Intellectual property and incentive bargaining

JV partners usually contribute some form of intellectual property (IP) to their joint ventures. The allocation of IP rights to the joint venture and among the partners and definition of the terms under which the IP may be exploited are the legal means of delineating the scope of the partners' and the joint venture's respective businesses. These issues are important matters that influence sharing of control, sharing of total return, and threat of exit.

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7.1 PLANNING RELATED TO HUMAN CAPITAL CONTRIBUTIONS TO JOINT VENTURES

7.1.1 Definition of IP and Contributions of Human Capital

The term "intellectual property" means inventions, devices, new varieties of plants, designs, works and other property that is produced through creative activities by human beings (including discovered or solved laws of nature or natural phenomena that are industrially applicable), trademarks, trade names, other marks that are used to indicate goods or services in business activities, and trade secrets and other technical or business information useful in business activities. IP rights include patent rights, utility model rights, plant breeder's rights, design rights, copyrights, trademark rights, other IP-related rights that are stipulated by laws and regulations, and rights pertaining to an interest protected by law. The legal protections that result from conferral of IP rights convert technical or reputational information into assets. In essence, IP rights grant the right to prevent third parties from unauthorized use of human intellectual works such as inventions, or devices and intangibles[1] such as trademarks,

[1] *See* Ian Hewitt, Hewitt on Joint Ventures, Ch. 17 (5th ed. 2011). US Treasury Regulation 26 CFR §1.482-4(b) broadly defines an intangible as an asset that "derives its value not from its physical attributes but from its intellectual content or other intangible properties," such as a license, franchise,

thereby conferring economic benefit through artificially created scarcity. Licensing of IP is one key objective for partners in many joint ventures and technology tie-ups. As such, it is subject to inter-partner bargaining.

In terms of human capital that JV partners contribute to their joint ventures, the partners must take into account, aside from vested IP rights, the actual extent to which legal status required for business operations (e.g., regulatory licenses) and use of know-how and other such information are legally protected. JV partners also must be aware that IP licensing is not only a means to earn monetary return in the form of royalties, but also a key issue that influences sharing of control and threat of exit. Additionally, by protecting the rights of and generating return for partners that have created IP, IP rights incentivize partners to contribute resources to their joint ventures to promote development of the joint venture's business and maintain competitive order between the partners, and between the joint venture and individual partners.

7.1.2 Motivation to Elect to Form a Joint Venture

Partner A and Partner B want to partner with each other to realize synergies through joint development or application of a technology. Partner A owns the technology and Partner B wants to commercially exploit it. Partner A could choose to furnish the technology directly to Partner B through a licensing agreement. Alternatively, the two partners could jointly form a corporation. Licensing agreements and joint ventures are not mutually exclusive alternatives. The question is whether the partners manage their cooperative or adversarial relationship and the licensed technology's mode of exploitation through direct contractual obligations as parties to a license agreement, or whether they indirectly manage these matters by organizing their relationship as a JV company.

7.1.2.1 In-kind contribution or transfer

If the partner that owns the IP (hereinafter referred to as the licensor partner) contributes it to the JV company as an in-kind capital contribution, the licensor partner would be able to acquire an ownership interest in the JV company through a nonmonetary capital contribution. If the licensor partner has no plans to exploit the IP in any of its businesses other than the joint venture, an in-kind capital contribution would enable it to expeditiously monetize the IP with certainty, acquire an ownership

customer list, system, or procedure. A licensor partner may also contribute sub-licensable IP rights owned by a third party.

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interest in the joint venture,[2] and signal commitment that will incentivize its prospective partner to contribute capital to the joint venture. If the licensor partner plans to operate an existing business in competition with the JV company, it will typically choose to license its IP. Even if the licensor partner does transfer the IP to the joint venture, it will license back the IP for use in its own businesses. However, once the licensor partner transfers its IP, it is at risk of losing its right to manage and dispose of IP in the event that it loses control of the JV company. Bargaining over sharing of control is therefore even more critical than usual in such a scenario.

From the standpoint of the partner that needs the licensor partner's IP to form the joint venture (the licensee partner), an in-kind contribution is preferable. When the licensor partner's human capital contribution to the JV company is converted to financial capital in the form of rights allocated to the JV company, the JV company is able to exercise the IP rights. Whereas in direct licensing agreement scenarios the licensor partner may sometimes skimp on providing IP to the joint venture, in the case of in-kind capital contributions of IP the licensor partner is prevented from partially withholding the IP and the scope for opportunistic behavior is limited.

7.1.2.2 Licensing

From the licensor partner's standpoint, licensing is more advantageous than transferring IP in certain respects even though the licensor partner will incur expenses to preserve its rights. The advantages include that the licensor partner retains the right to manage and dispose of the IP rights, is able to control the terms of the license, and can effectively recover its IP by terminating the license agreement at the joint venture's conclusion.

If the IP is licensed directly to the licensee without creating a joint venture, the licensor is at risk of competing behavior by the licensee. The licensee could potentially master the licensed technology and the licensor could lose its controlling right over the licensee after termination of such license agreement. And then the licensee could become a competitor in the same or similar technological domain as the licensor. However, the licensor partner can control this risk by licensing its IP to the JV company. If the licensor partner is involved in the joint venture's

[2] If a licensor partner contributes IP rights to a JV company as an in-kind capital contribution, the licensor partner's share of total returns attributable to the IP rights would be a return on investment. If the licensor partner licenses IP rights to the JV company, its share of total returns attributable to the IP rights would be a return from transactions.

management, it will also be able to participate in decision-making and/or monitoring regarding how the licensed IP rights are exercised by the JV company.

From the licensee partner's standpoint, direct licensing of IP is more advantageous if the licensee partner intends to independently pursue opportunities. While use of a JV company would limit such opportunities, it may work to dispel the licensor partner's reservations, thereby incentivizing the licensor partner to contribute its IP to the joint venture.

If the licensor partner grants a license to a JV company, a joint venture can better enable the exchange of not only documented formal knowledge, but also implicit knowledge through information sharing and human interaction within the JV company. Establishment of a joint venture should therefore facilitate the transfer of knowledge from the partners to the JV company and increase JV synergies.

Situations that warrant particular attention include (a) direct competition between the JV company and a solely owned business of the licensor partner, (b) transfer of the licensed IP rights from the licensor partner to a third party, in some jurisdictions requiring perfection such as registration, resulting in the loss of the JV company's license against the assignee, (c) emergence of a rival company as a result of the licensor partner granting another license to a third party or a leak of know-how through a technology tie-up, and (d) continued payment of royalties on worthless IP in perpetuity.

7.1.3 Opportunities and Threats between Partners: Technology Tie-up Schemes and Avoidance of Potential Competition

If a licensor partner directly licenses the IP to, or enters into a joint development contract with, the other partner, the co-partner may independently gain sufficient knowledge of the IP to become a potential competitor of the licensor partner.[3] However, by licensing IP to a joint venture, the licensor partner can prevent the emergence of a rival if it structures the licensing arrangement as a "black box" designed to preclude use of its know-how by the other partner, accumulates technology and/or reputational assets in the JV company, and retains control of the JV company. Additionally, IP rights are territorial. IP licenses can be limited in scope in non-territorial terms also. Consequently, if a licensor partner and a JV company operate identical businesses, they can

[3] *See* Gordon V. Smith & Russell L. Parr, Intellectual Property: Licensing and Joint Venture Profit Strategies 359–391 (1993).

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divide the market geographically or by product/service segments – subject to the constraints of antitrust law.

When IP rights required to operate a joint venture are licensed, the licensor partner must first decide on the licensee, the license's geographic scope (territory), the objective scope of the licensed product(s) and/or service(s), and the license's duration. The licensor partner must then decide whether to grant the JV company nonexclusive rights or to prohibit the other partner from competing with the JV company by granting exclusive rights to the JV company. Other matters to consider include rights to access or use information regarding the fruits of the joint venture's operations. If the partners want to clearly delineate their respective solely owned businesses from their joint venture's business, they will use an exclusive license.

The IP holder partner may sometimes be concerned about the risk of losing IP through cooperative relationships. Information is inherently susceptible to copying. Once obtained, knowledge cannot be repossessed. JV partners sometimes gain the know-how of the other partner in the course of running their joint ventures and apply that know-how to their solely owned businesses. Partner companies from developed countries that form joint ventures with local partners in developing countries and transfer technology to the joint ventures sometimes face the threat of a "boomerang effect," where the local partner becomes a rival after the JV company's dissolution and encroaches on the developed-country partner's home market.

Since know-how can be used freely if obtained legally, prospective licensor partners must take precautions against the possibility of a breakdown in negotiations before disclosing know-how to a prospective partner. Such precautions include entering into a nondisclosure agreement that imposes a duty of confidentiality and prohibits use of the know-how for unauthorized purposes and/or signing a memorandum of understanding regarding exploitation of IP rights and use of the know-how. Through such means, JV partners can protect their IP, including patents and know-how pertaining to technologies related to the joint venture, even during the preparatory stages of establishing a joint venture. Given that joint ventures may end up being relatively short-lived enterprises, a partner must also be cognizant of the risk of the other partner utilizing know-how in its solely owned businesses and becoming a competitor after the joint venture has been terminated.

7.1.4 Human Capital Contributions and Monitoring

7.1.4.1 Human capital contributions at inception of joint venture

When a JV partner contributes IP rights to a joint venture, a key issue involves the identification and valuation of IP that is essential to the joint venture in light of the joint venture's purpose. Valuation of IP is directly connected with valuation of JV ownership interests and sharing of return on investment in cases where an in-kind capital contribution of IP was made at the joint venture's inception. If a partner definitively and permanently contributes essential resources such as patent rights to a joint venture by assigning them or contributing them as an in-kind capital contribution, the partner's equity ownership interest at the time of the joint venture's inception will increase, but the partner is also giving the other partner an opportunity to earn return on investment from the IP. Conversely, if the partner retains ownership of those resources and furnishes them to the joint venture through a patent license agreement, the partner is able to benefit exclusively from royalty income on an ongoing basis as a return from the patent license.[4]

7.1.4.2 Antitrust implications of license terms and avoidance of competition with JV partners

If a licensor partner operates a solely owned business in parallel with its joint venture in the same market in which the joint venture operates or a market related thereto, the partner and JV company must be mutually prohibited from operating businesses in competition with each other within the scope of the joint venture agreement. Such a prohibition is needed to prevent spillovers, where the JV company expands its operations beyond its geographic territory or product markets or, conversely, the licensor partner expands its solely owned business to encroach upon the scope of the joint venture's business. This prohibition also prevents free-riding on resources contributed by another risk-bearing licensor partner.

For a licensor partner, a duty not to compete has disadvantages as well as advantages. Specifically, the licensor partner loses the freedom to operate a solely owned business in the same business domain as the joint venture if the joint venture's business is not as successful as anticipated. In cases where a less restrictive alternative to a non-compete clause exists, licensor partners must be aware that antitrust issues could arise and that the exchange of market information between partners through

[4] *See* Hewitt, *supra* note 1, at Ch. 17-21.

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monitoring may constitute circumstantial evidence of conspiracy.[5] If JV partners adopt a business strategy of contributing all of their available financial and human capital to the joint venture's business and refraining from operating similar businesses themselves, such a strategy is less problematic except when a partner exits the joint venture. However, if the partners continue to operate solely owned businesses similar to their joint venture's business, they face a conflict of interest.

IP rights are country-specific in accord with the principles of territoriality. Patents granted in different countries for the same invention are independent of each other. IP rights can be restricted to a licensed territory or specific country. By drafting license agreements that limit the scope of licensed products/services and the license's geographic scope pursuant to the principle of territoriality, JV partners can delineate territories between themselves and their joint ventures. Even if a license has a procompetitive effect, it still needs to be assessed to determine if it is substantively illegal by analyzing economic factors and weighing the procompetitive effect against its anticompetitive effect attributable to market partitioning.

Because IP creates market power, license agreements between JV partners and their joint ventures must be vetted with respect to antitrust law issues. For example, such license agreements must be analyzed to determine whether the license constitutes a monopoly or conspiracy prohibited by antitrust law (see Sherman Antitrust Act, 15 U.S.C. §1 and 2, Clayton Act, 15 U.S.C. §7, and Japan's Antimonopoly Act, Article 3). JV partners must also be careful to avoid contractual terms that could constitute unfair trade practices or unfair methods of competition that would substantively restrain competition or unreasonably restrain trade or commerce in the relevant market. Examples of such terms include tying of goods purchases to a patent license or an assignment back of improvement inventions constituting patent misuse.[6]

License agreements and joint ventures are means of realizing similar economic effects through different legal structures.[7] Technology tie-ups and business combinations have commonalities and differences. A JV

[5] *See* Brian G. Brunsvold, Dennis P. O'Reilley, and D. Brian Kacedon, Drafting Patent License Agreements, 405–451 (6th ed. 2008).

[6] *See Statutory Provisions and Guidelines of the Antitrust Division*, www.justice.gov/atr/public/divisionmanual/chapter2.pdf.

[7] *See* Japan Fair Trade Commission, *Guidelines to Application of the Antimonopoly Act Concerning Review of Business Combinations* (May 31, 2004; amended June 14, 2011) www.jftc.go.jp/en/legislation_gls/imonopoly_guidelines.files/110713.2.pdf.

company may be exempt from antitrust laws in the context of its parent–subsidiary relationship. Consequently, JV partners may be able to undertake business activities that exploit licensed technologies through shared management control of the JV company. By contrast, license agreement clauses such as restrictions on the sale of licensed products pose a risk of violating antitrust laws. JV partners should accordingly engage in planning based on case law and fair trade authorities' guidelines to minimize antitrust risk while also achieving their joint ventures' intended objectives. Such planning involves reviewing national antitrust authorities' guidelines with respect to IP license agreements.[8]

7.1.4.3 Monitoring

Another issue that ought to be addressed at the time of a joint venture's inception is how to monitor whether the other partner has actually contributed IP rights to a JV company. The answer to this question is obvious when the IP in question is a brand, but when the IP consists of patents or know-how, determining whether the licensor partner has fully contributed technology essential to the joint venture's business can be difficult. Know-how is intrinsically difficult to specify in its entirety before it is disclosed. Proving that the other partner has in fact failed to perform its obligations is likewise difficult. Practical means of addressing such difficulties include: due diligence conducted by experts during preparatory stages, and monitoring. Monitoring can be accomplished through such means as ascertaining the technological composition of the joint venture's products manufactured through exploitation of patented know-how and verifying the product performance attainable through use of that know-how.

Once a joint venture is operational, partners must monitor the opportunistic behavior of the other partner whose solely owned business spills into the joint venture's rightful business domain. Likewise, the JV company's competitive behavior in the rightful business domains of businesses solely owned by partners may also need to be monitored. In

[8] For guidelines regarding IP licensing and antitrust law, *see* national competition authorities' latest guidelines, such as Japan Fair Trade Commission, *Guidelines for the Use of Intellectual Property under the Antimonopoly Act* (September 28, 2007; amended January 1, 2010) www.jftc.go.jp/en/legislation_gls/imonopoly_guidelines.files/070928_IP_Guideline.pdf; US Department of Justice and Federal Trade Commission, *Antitrust Guidelines for Licensing of Intellectual Property*, www.justice.gov/atr/public/guidelines/0558.htm; and *Antitrust Enforcement and Intellectual Property Rights – Promoting Innovation and Competition* (2007) www.justice.gov/atr/public/hearings/ip/222655.pdf.

particular, a JV partner must monitor the other partner's opportunistic behavior by imposing duties with the prior written consent of the partner or through advance notification and after-the-fact reporting with respect to newly consummated license agreements and key R&D agreements between the partners and the JV company. Among transactions of which a JV partner is notified in advance, it is also important for the partner to have veto rights over designated types of transactions or transactions whose value exceeds a specified materiality threshold. Such transactions should also be subject to the approval of the JV company's board of directors. In order to delineate the scope of counterparties in cooperative relationships, it is also important to monitor (1) acts aimed at forming alliances between a licensor partner and third parties other than the other partner within the domain of a licensed technology, and (2) sub-licensing arrangements that could give rise to a potential competitor. Lastly, from the standpoint of deciding how contributed resources will be used through participation in management, a licensor partner should monitor its joint ventures by vetting new-business plans and investment plans to ensure that JV companies do not stray beyond the scope of their businesses even if they stay within their defined physical boundaries.

7.1.4.4 JV companies as licensees

When a JV company is in the process of being established, the content of IP license agreements between a licensor partner and the JV company is negotiated between the JV partners. Once the JV company is operational, however, the value of the licensed IP typically changes over time. Accordingly, the licensee must avoid the risk of continuing to pay unwarranted remuneration for obsolete technology by ensuring that it has the opportunity to periodically review and, if necessary, renegotiate license agreements. When a license agreement is renegotiated while a joint venture is in operation, the legal entity that renegotiates the license agreement with the licensor partner is the licensee – i.e., the JV company – not the other partner. License agreement negotiations between a JV company and a JV partner (Partner A) that owns IP rights essential to the joint venture's business typically take one of two forms. First, a JV company director effectively appointed by Partner B may negotiate on behalf of the JV company. In such cases, the JV company is substantially acting as Partner B's agent and the negotiations are a proxy contest where the JV company's representative negotiates to protect Partner B's interests with respect to the arrangement for sharing total return stipulated in the JV agreement. Second, in cases where the JV company has gained autonomy, it may negotiate with the aim of protecting its own interests.

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effectively equivalent to shareholder general meetings in terms of authority. In the event of a deadlock, partners sometimes form ad hoc committees in hopes of reaching an agreement before having to resort to arbitration. Because operating committees, in effect, enable shareholders to directly manage a JV company, they also dilute the joint venture's independence.

12. Termination of the joint venture

The final stage of post-contract bargaining is termination of the joint venture, in other words, exit of at least one partner.

12.1 TERMINATION BY AGREEMENT

Broadly speaking, termination provisions in a joint venture agreement generally fall into one of two categories. First, one or both partners may exit the joint venture while keeping the JV company in operation, preserving its value. Second, the partners may dissolve the JV company. The first of these categories has four variations: (a) conversion of the joint venture into one partner's solely owned business, usually through a buyout of the other partner's stock;[1] (b) replacement of one partner through sale of its equity stake to a third party; (c) conversion of the joint venture into a third party's solely owned business through M&A; and (d) sale of the JV company to the public through an IPO.

12.2 TERMINATION WITHOUT AGREEMENT

12.2.1 Buyout/Sellout[2]

When JV partners' decisively conflicting interests prevent them from reaching an agreement, the joint venture may be terminated through

[1] For example, Ajinomoto and Unilever entered into a share sale agreement on February 18, 2003, in conjunction with termination of their joint ventures in six Asian countries/regions, as the two companies wanted to pursue their own independent business strategies in Asia. Under the share sale agreement, Ajinomoto sold its entire shareholdings in seven JV companies to Unilever Group companies in two installments. *See* www.ajinomoto.co.jp/ajinomoto/press/2003_02_18_1.htm. Key issues in terms of execution of this option are (1) timing, (2) price (valuation standards and procedures), and (3) funds required to buy out the exiting partner. Regarding share sale agreements, *See* IAN HEWITT, HEWITT ON JOINT VENTURES, Precedent 14 (5th ed. 2011).

[2] See id., at Ch. 12.

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compulsory exit by one of the partners. Potential means of compulsory exit include (a) one partner's exercise of a put or call option granted as an exit right at the time of the JV company's establishment, (b) one partner's de facto put option via a threat to exacerbate the losses on the other partner that would be incurred if the joint venture were dissolved by a court order, and (c) rescission of the joint venture agreement due to material breach of joint venture agreement by the other partner.

When JV partners are unable to reach an agreement and the exit mechanisms designed at the time of the joint venture's establishment do not work, other options include arbitration, voluntary dissolution of the JV company, termination of the JV company due to business failure, and litigative dissolution, where the JV partners square off in an adversarial relationship and terminate the JV company through bankruptcy proceedings. When a JV company's largest creditor is its parent company, the parent company may seize control of the JV company through corporate reorganization proceedings and squeeze out the other partner through a capital reduction, thereby converting the joint venture into its own solely owned business.

12.2.2 Arbitration

Joint venture agreements often include clauses that require partners to submit to alternative dispute resolution,[3] particularly arbitration, when they are involved in a dispute and unable to reach an agreement between themselves. However, by the time JV partners agree to go to arbitration, the joint venture's survival is often in doubt. In such cases, rather than proceeding on the unrealistic assumption that the joint venture will continue, the arbitration often ends up determining the terms of the joint venture's termination.

One advantage of arbitration is that disputes can be resolved more expeditiously and less expensively than if the matter were decided by protracted judicial proceedings in a three-tiered court system. Arbitration cases can be resolved by a specialized arbitrator in a single round of proceedings, enabling greater procedural flexibility.

A second advantage is that arbitration can resolve disputes more flexibly than the courts, particularly in continental-law countries like Japan.[4] Arbitral awards can also be based on conventions other than a

[3] *See id.*, at Ch. 14.

[4] In civil litigation in continental-law countries such as Japan, judicial decisions are based on the elements and burden of proof required with respect to a specified cause of action.

country's positive law. Unlike the courts, arbitrators can, even without rights under positive law, comprehensively reconcile the disputants' interests, including altering relationships outside the purview of the cause of action.

Third, it is possible to have arbitral awards based on specialized knowledge because, unlike the generalist judges found in traditional court systems, the parties can agree on an arbitrator with specialized knowledge pertinent to their dispute.

Fourth, arbitration is a particularly popular dispute resolution procedure in cases in which one or both partners have little trust in or familiarity with the court system of the country in which the JV company was established. If a dispute involves an international joint venture, the JV partners can transcend national sovereignty by having their dispute arbitrated in a third-party country. In developing countries where trust in the national judicial system is low, arbitration may yield a more fair resolution than the courts, especially when parties are disadvantaged in terms of retaining competent legal counsel due to unfamiliarity with the local language, legal system, or legal procedures. When a dispute pertains to the joint venture agreement or an ancillary agreement between partners, the partners can avoid the disadvantage of arguing their cases in an unfamiliar local language and court system if they enter into an international commercial arbitration agreement.

Fifth, arbitral hearings and awards can be kept confidential, unlike court decisions, which generally become public knowledge.

Arbitration's disadvantages include, first, that disputants must agree in advance to submit to arbitration.[5] Second, the disputants may not be able to agree on the appointment of an arbitrator. Third, parties to arbitration cannot be compelled to submit documents, so the refusal of one party could obstruct discovery. Fourth, arbitration is generally infeasible when a large number of disputants are involved; it is best utilized as a method of resolving one-to-one disputes. Fifth, compulsory enforcement of an arbitral award requires a separate enforcement order.

12.2.2.1 Arbitration rules and arbitral bodies

It is important for JV partners to specify their agreed arbitration rules and arbitral body in the joint venture agreement. The most prominent

[5] For a sample arbitration agreement form, *see* Hewitt, *supra* note 1, at Precedent 21. Joint venture agreements generally contain an arbitration clause, but the clause may not be drafted in sufficient detail to be enforceable. Consequently, when partners renegotiate once a dispute has arisen, one partner may refuse to sign an arbitration petition.

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arbitration regulations are the United Nations Commission on International Trade Law's (UNCITRAL) New York Convention (United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards).[6] UNCITRAL Arbitration Rules and the UNCITRAL Model Law on International Commercial Arbitration are commonly used as ad hoc arbitration rules.[7] Other important rules include the International Bar Association's Rules on the Taking of Evidence in International Arbitration.[8] The International Centre for Settlement of Investment Disputes (ICSID) is an important institution for joint ventures involving the governments of developing countries.[9]

12.2.2.2 Governing law and arbitral forum

In terms of governing law and arbitral forum selection, it is advisable for JV partners to choose a neutral, third-party country that is neither partner's home country.

12.2.2.3 Arbitrators

Arbitrators may be selected and challenged by the disputants, an arbitral body, or a court. JV partners should stipulate arbitrator selection criteria in advance to avoid being unable to appoint arbitrators when a dispute occurs. Disputes involving joint ventures are typically arbitrated by a panel comprising three arbitrators, with both partners and a neutral third party (e.g., an arbitral body) each appointing one of the arbitrators.

12.2.2.4 Arbitral awards' binding force and enforcement

Arbitral awards have formal legal force (i.e., they are equivalent in legal effect to a final judicial judgment). To enforce an arbitral award, one must petition a national court for compulsory enforcement. In Japan, enforcement is guaranteed by the Convention on the Recognition and Enforcement of Foreign Arbitral Awards. In Japan it is easier for a party to petition for and receive compulsory enforcement of a foreign arbitral award than a foreign court judgment, without having to re-litigate the matter. JV partners should be aware that foreign arbitral awards may be unenforceable if they contravene local law.

6 www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention. html.
7 www.uncitral.org/uncitral/uncitral_texts/arbitration.html.
8 www.ibanet.org/.
9 https://icsid.worldbank.org/ICSID/Index.jsp.

12.2.3 Judicial Dissolution

The availability of and procedures for judicial dissolution vary widely by jurisdiction. In Japan, for example, a minority shareholder may petition the courts for judicial dissolution of a corporation in the event of a deadlock or other such irresolvable management impasses (Companies Act Article 833). Similarly, under UK law, companies may be compulsorily dissolved pursuant to the Insolvency Act §122(1)(g).[10] Delaware General Corporation Law § 273 provides a mechanism for the judicial dissolution of a joint venture corporation having only two stockholders, each of whom owns 50 percent of the stock therein.[11] Aside from this specific situation, Delaware corporate law does not allow shareholders to petition a court for the compulsory winding-up or judicial dissolution of a JV corporation.[12] Under Delaware's LLC Act (§18-802), however, the court may appoint a liquidating trustee to wind up an LLC's affairs.[13] New York Business Corporation Law provides judicial dissolution not only for deadlock cases (§1104), but also in cases of oppression (§1104-a).[14]

10 *See* Hewitt, *supra* note 1, at Ch. 13-50; Ch. 11-42. Additionally, upon a showing of unfairly prejudicial conduct, such as oppression of minority shareholders, a court may make a wide range of orders including a buyout of the complainant's share. *See* U.K. Companies Act, 2006, §§994, 996.
11 *See e.g.*, In the Matter of Bermo Inc., C.A. 8401-VCL (Del. Ch. Feb. 9, 2015) http://courts.state.de.us/opinions/download.aspx?ID=219060.
12 Only one case seems to have granted the remedy of dissolution on the ground of persistent breach of fiduciary duty owed to the minority shareholder. *See* Carlson v. Hallinan, 925 A.2d 506 (Del. Ch., 2006). Also, Delaware General Corporation Law §226 provides for the appointment of a custodian in cases of deadlock, either at the shareholder or director level.
13 *See* Spellman v. Katz (In re KSA, L.L.C.), C.A. No. 1838-VCN, 2009 WL 418302 (Del. Ch. Feb. 6, 2009); Lola Cars International Limited v. Krohn Racing, LLC, et al., C.A. No. 4479-VCN (Del. Ch. Nov. 12, 2009) http://www.nybusinessdivorce.com/uploads/file/Lola.pdf. In this case, the Delaware Court of Chancery refused to dismiss dissolution claims arising out of a deadlocked joint venture structured as a limited liability company.
14 *See* Matter of Kushner (Smiles Candy Corp.) www.nybusinessdivorce.com/uploads/file/KushnerOrder. *See also* Model Bus. Corp. Act §14.30(2) (2005).

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12.2.4 Termination Due to Bankruptcy

12.2.4.1 Bankruptcy of JV company

JV companies are generally resistant to bankruptcy because their parent companies tend to assume responsibility for their obligations before they become insolvent. However, the rare case of a JV company's bankruptcy due to unprofitable operations generally involves one of two scenarios. In one scenario, the JV company files for bankruptcy or corporate reorganization at the direction of the parent company from which its chief executive was appointed.[15] In the second scenario, one partner petitions to initiate bankruptcy or reorganization proceedings as a result of a dispute with the other partner.

12.2.4.2 Bankruptcy of a partner

Joint ventures run their businesses with the reputational backing of the JV partners. If a partner goes bankrupt, the subsequent loss of ongoing access to human capital renders the joint venture dysfunctional. Additionally, the JV company may lose the confidence of creditors and other financiers. The bankruptcy of a partner involved in a joint venture's operations consequently tends to lead to failure of the joint venture's business and is therefore generally grounds for rescission of the joint venture agreement.

12.3 PRACTICAL ISSUES RELATING TO JOINT VENTURE TERMINATION

12.3.1 Inter-Partner Agreements and Corporate Law Procedures

Shareholder general meeting resolutions under corporate law are a matter separate from the joint venture agreement. Therefore, even if the joint venture agreement is rescindable, dissolution of the JV company requires separate legal procedures (e.g., a special resolution at a general meeting

[15] For example, Spansion Japan, a Japanese JV company co-owned by Fujitsu and major US semiconductor maker AMD, filed for corporate reorganization at the Tokyo District Court on February 10, 2009. Its total liabilities at the time were ¥74.1 billion. *See* http://investor.spansion.com/phoenix.zhtml?c=189782&p=irol-newsArticle&id=1405135.

of shareholders that requires both partners' consent to convene).[16] However, if grounds for dissolution are stipulated in the articles of incorporation, one partner can commence dissolution proceedings under corporate law without the other partner's consent upon occurrence of any of the stipulated grounds for dissolution.[17]

12.3.2 External Barriers to Exit

Even after a JV company has been dissolved, numerous issues remain, including political issues in developing countries, distribution of residual assets or allocation of residual losses, dismissal of employees, handoff of suppliers and customers, assumption of financial claims and liabilities, and allocation and utilization of patents and know-how. Joint ventures tend to involve complexly intertwined ancillary agreements such as license agreements and continuous supply agreements. Termination of a joint venture thus usually entails more than just settlement of the partners' ownership interests. The following is an overview of matters requiring action by the partners upon dissolution of the joint venture.[18]

12.3.2.1 Succession of licenses

Special care is required in countries that require government approval to dissolve a JV company or transfer stock in a local company to a foreign company. Depending on the country's government regulations on international joint ventures, government authorities' approval may also be required for actions such as buyouts that convert the JV company to a wholly owned subsidiary of a foreign partner or dissolutions of JV companies. Even when a foreign partner is permitted to completely buy out its local partner, it may not necessarily be able to assume the business licenses or permits that were granted to the JV company by virtue of the local partner.

[16] *See* 8 Del. Code §275. In Japan, without a written record of the shareholder general meeting's special resolution that dissolved the JV company, a stock corporation's dissolution cannot be recorded in the public registry and the corporation cannot be liquidated (Companies Act Article 926; Commercial Registration Act Article 72).
[17] Regarding judicial dissolutions, *see supra* 12.2.3.
[18] *See* Hewitt, *supra* note 1, at Ch. 13-20–33; Ch. 20-21. In the case of international joint ventures in developing counties, foreign partners could assume a potential risk of change in regulations by local government that impose a special liability on the foreign investor.

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12.3.2.2 Handoff of suppliers and customers

When one partner takes over a joint venture's business following the dissolution and liquidation of the JV company, taking over or terminating relationships with suppliers and customers can be a difficult task in practice. One difficulty is determining which party will bear the cost of maintaining business relationships that cannot be terminated. Continuous supply agreements, for example, are difficult to unilaterally terminate. If a JV company has business relationships that cannot or should not be terminated, the partners will have to decide which one of them will take over the JV company's obligations. In doing so, they should consider which one of them (a) has more of a competitive advantage by virtue of similarity (in terms of, e.g., business model, technology, geographic proximity, experience) between its own operations and the JV company's business, (b) is more motivated to diligently run the business, and (c) is more committed to maintaining relationships with suppliers and customers because it stands to gain from doing so even after assuming the liabilities and responsibilities of the JV company's business. Based on these factors, the partner for whom it is more economically rational typically takes over the JV company's business, subject to any constraints on its capacity to assume risks as the ultimate loss-bearer. If either partner assumes a duty to avoid operating a business in competition with the joint venture, it must be careful to comply to the extent that it remains bound by this duty after the JV company's dissolution.

12.3.2.3 Succession and dismissal of employees

When a JV company is dissolved and liquidated, any secondment agreements between the partner and JV company cease to be enforceable. Typically, some or all of the seconded personnel return to the employment of the JV partner from which they were seconded. Employees hired by the JV company itself, however, must be dismissed because their employment contracts terminate once the JV company ceases to exist, though they may be rehired by one of the partners, one of the partner's affiliates, or a supplier of the former JV company. However, while management has the right to discontinue operations, it may not necessarily have the freedom to dismiss workers. In international joint ventures in particular, JV partners must beware of local legal restrictions on the dismissal of employees.

12.3.2.4 Return of in-kind contributions and IP rights

When a JV company is dissolved and liquidated, monetary capital is first returned to the JV partners through distribution of the company's residual assets. Second, the cancellation of ancillary agreements may result in further assets that can be returned to the partners. For example, upon cancellation of a lease agreement, a partner may demand the return of specific property and restoration of the leased premises to their original condition. Another example is that a partner may take possession of the JV company's inventory pursuant to cancellation of a product sales agreement or execution of a sales agreement between a partner and the joint venture to transfer the title of tangible assets owned by the joint venture to the partner. Human capital in the joint venture's possession as of the time of its termination pursuant to cancellation of ancillary agreements is also distributed to the partners. For example, when a secondment agreement is terminated, skilled employees could be returned to a partner.

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Further, a JV company's residual economic value is not limited to its residual assets booked, according to generally accepted accounting principles and corporate law, on the balance sheet of the joint venture. Tangible and/or intangible assets not recorded in the books may include, for example, the JV company's rights to patent inventions for which a patent application is pending or not yet filed, R&D processes' interim deliverables (e.g., drawings, specifications, and prototypes), computer programs, and databases. JV partners sometimes take possession of such assets and utilize them in their solely owned businesses.

Transfers of certain types of assets or rights (e.g., mining rights) require the permission of government authorities. JV partners need to be aware that such rights may not be transferable from the JV company to a partner in some cases.

12.3.2.5 Warranties to successors

If a third party wholly or partially takes over a joint venture's operations, the third party and JV partners must reach an agreement on which of them assumes liability in the event of a patent infringement dispute or product liability problem stemming from a defect in products already sold.

12.3.2.6 Partners' duties of confidentiality and noncompetition after the joint venture's termination

In joint venture agreements, the partner that is to take over the joint venture's operations after its termination sometimes imposes duties on the other partner to shield itself from any adverse repercussions of the other partner's actions. Such duties may include a duty of confidentiality, a prohibition against using information for unauthorized purposes, and/or a duty to refrain from competition for a specified time frame after the joint venture's termination. A duty to refrain from competition limits the

duty-bound partner's freedom to conduct future business activities. The partner must therefore carefully scrutinize the terms of such an agreement, including its operational scope, geographic scope, and time frame. Additionally, in the case of a joint venture between competitors, the partners must exercise care so that a duty to refrain from competition is not found to constitute a cartel in violation of antitrust laws.

12.3.2.7 Long-term tort liability

Even after exiting, JV partners sometimes remain legally liable for the past actions of the joint venture. For example, if a now-defunct JV company had polluted the environment while it was in existence, the JV partners may be forced to assume the JV company's tort liability. In one case, a joint venture contaminated the soil surrounding a chemical manufacturing plant with polychlorinated biphenyls (PCBs), which are dioxin-like compounds. A company formed through a merger with the parent company upon dissolution of the joint venture was subsequently ordered to bear some of the site remediation costs. The order was upheld by the Tokyo High Court.[19]

12.3.2.8 Sharing of joint venture losses

12.3.2.8.1 The principle of shareholder limited liability and the sharing of joint venture losses JV partners are in effect unable to benefit from shareholder limited liability in some cases. In practice, it is difficult for partners to escape from a joint venture when the JV company is in default on its obligations. When the partners have entered into an agreement to guarantee the performance of the joint venture or undertake its liability to a third party with respect to their JV company's transactions with unrelated parties, the partners must perform the JV company's obligations if they guaranteed the obligations.[20]

Additionally, even if the partners have not guaranteed the JV company's obligations, compulsory government regulations may require partners to share the JV company's losses by withdrawing personnel seconded to the JV company, arranging for the rest of the JV company's workforce to be rehired by affiliated companies, fully repaying the JV

[19] *See* in re Mitsubishi Gas Chemical, 1309 Hanrei Taimuzu 137 (Tokyo High Ct., Aug. 20, 2006).

[20] This situation is similar to a general partnership, in which partners are allocated shares of losses of the joint venture. In Japan, the partners may be liable for damages pursuant to a comfort letter, which is often required by a lender.

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company's creditors, and taking over business operations essential to suppliers and/or customers.

12.3.2.8.2 Assumption of JV company's debts Joint venture agreements sometimes contain a debt assumption clause (also known as a "basket clause") stipulating that the parent companies will assume the JV company's debts in the event of the JV company's dissolution or liquidation. For example, Company A may agree to assume accounts-payable obligations that arise in the course of the JV company's operations while Company B agrees to fulfill the JV company's lease obligations. Legal liquidation (e.g., a bankruptcy filing) is an option of last resort to allow the partners to exit from the joint venture without assuming all of the JV company's liabilities. When the JV partners have not agreed in advance to assume their JV company's liabilities, the partners must renegotiate and agree on how to share losses before they can liquidate the JV company.

Even if JV partners have entered into a loss-sharing agreement in advance, they may not be able to liquidate their JV company in accord with their agreement. In such cases, one or both partners may end up bearing losses in excess of their legal liability under corporate law or the joint venture agreement. For example, even if the partners fulfill their own contractual responsibilities in accordance with the joint venture agreement, they may still face the risk of damage to their external reputations. Such reputational damage may take the form of being shunned by prospective customers and/or perceived as unreliable by prospective alliance partners. The partner that faces the most reputational risk and would incur more costs is therefore likely to be at a disadvantage in renegotiating loss sharing with the other partner. Other examples include joint ventures that need governmental license such as electric power companies, where the partners are at risk of revocation of their licenses upon dissolution of the JV company. In such a situation the partner that is most committed to maintaining its license would be at a disadvantage in renegotiations.

12.3.2.8.3 Partners' liability for joint venture's conduct A parent corporation is not liable for the contracts or tortious acts of its subsidiary. However, a parent company could be jointly and severally liable for its subsidiary's debts based on the principle of piercing the corporate veil, apparent or ostensible agency, or *alter ego*/unity of interest doctrine, as these legal theories may be applied to joint ventures. In addition, when joint ventures are engaged in high-risk businesses (e.g., resource extraction) or involved with a national government, the JV partners are less

likely to be able to assert limited liability. For example, concerning compliance with environmental regulations adopted to resource extraction business, partners in the resource extraction business should be careful about complying with environmental regulations, as parent companies are held liable for environmental incidents or damage done by the joint venture.[21] They accordingly entail an additional element of risk, which partners should account for in both the operational and termination phases of a joint venture.

12.3.2.8.4 Risk of shareholder derivative actions Although a company's acts and liabilities are not attributed to its shareholders in most jurisdictions, when a JV company has failed, it may not be socially permissible for its parent companies to renounce liability. Thus, when JV companies are dissolved, the JV partners sometimes lend funds to the JV company for the purpose of fully repaying its debts and then discharge the loan. If the directors of a JV partner are subsequently sued by its shareholders for forgiving a loan to the joint venture, the directors' liability would likely be decided based on the business judgment rule.[22] The court would presumably rule that the partner's directors did not violate their fiduciary duty of care if (a) the factual basis of their decision was free from material errors, (b) their decision was reasonable in terms of both its process and content, and (c) they did not overstep their discretionary authority.

[21] For example, MOEX Offshore agreed to a $90 million partial settlement of liability in the *Deepwater Horizon* oil spill, which occurred in the Gulf oil exploration project. A subsidiary of Mitsui Oil Exploration Corporation, MOEX Offshore, invested a minority stake in the joint venture that operated the oil exploration project. *See* Department of Justice, Office of Public Affairs (February 17, 2012) www.justice.gov/opa/pr/moex-offshore-agrees-90-million-partial-settlement-liability-deepwater-horizon-oil-spill. On the subject of the other parent company's liability in the environmental field, *see* Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) 42 U.S.C. §1906 et seq. and other state statutes.

[22] Although the standard varies by jurisdiction, in general, to survive the business judgment rule, directors should (a) be free of personal interest or self-dealing, (b) be in good faith, (c) make an informed decision, which reflects a reasonable effort, (d) act in a manner that they reasonably believe to be in the best interests of the corporation, and (e) act with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances.

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12.3.2.8.5 Tax treatment of losses If JV partners bear their JV company's losses, they must be aware of the tax ramifications (e.g., gift taxation) of doing so. A partner should consult with tax experts about the losses' tax-deductibility when (1) the partner assumes the joint venture's debts, bears its losses, or discharges loans to the venture in conjunction with the venture's dissolution or transfer of control, and (2) its decision to do so is justifiable on the grounds that the partner would incur larger losses in the future if it had not done so.