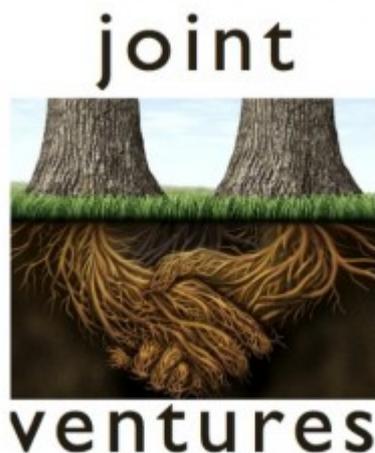


Joint Ventures: 25 FAQs – a guide for CEOs and CFOs



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1 What is a Joint Venture?

A “Joint Venture” is a structure where two (or more) businesses create a separate Joint Venture business to pursue a common goal. But any kind of collaboration with another company could be described as a Joint Venture.

2 What types of Joint Ventures are there?

There are many examples of collaborations between businesses – common ones are the following structures where two or more people share resources and risk:

1. setting up a separate Joint Venture company where each party has a shareholding and can appoint directors to carry out a specific (and often finite) project such as development of a new product
2. contractual arrangements such as entering into a distribution agreement
3. forming a partnership
4. merging two businesses.

The rest of this article covers the first structure above where each person in the Joint Venture has a shareholding and appoints directors

3 Who will be part of the Joint Venture?

The people contributing the assets to the Joint Venture, or JV, will all be parties to the Joint Venture Agreement.

4 Will the Joint Venture company or other vehicle itself be a party to the Joint Venture agreement?

Usually, Yes so that shareholders can enforce against the company.

5 What issues do I need to consider when looking for a Joint Venture partner?

Look for a JV partner with complementary strengths: eg a software product which you can distribute through the Joint Venture.

Take time to understand fully what your partner’s purpose and objectives will be from the JV. You will need to be able to agree objectives that suit both of you.

You will also need to reach agreement on a whole range of other issues as well as the JV agreement.

Consider at the outset what happens when the JV comes to an end. This can make it difficult to collaborate with a competitor or with a business that is likely to compete with you in the future.

6 How do I start negotiating a Joint Venture ?

□ You can ask for a period of exclusive negotiation so you do not waste time and costs negotiating the JV if the other party pulls out?

□ You can agree a Confidentiality Agreement (known as a Non-Disclosure Agreement or NDA in the US) to ensure all negotiations are kept confidential.

□ You can undertake a feasibility study and/or valuation first.

□ You can negotiate a Heads of Terms first.

7 How do I negotiate Heads of Terms?

The Heads Terms document sets out the main principles for the Joint Venture and the steps and documents required to get it set up. Read more about [negotiating Heads of Terms Agreements](#).

8 How do I protect myself while I am negotiating a Joint Venture?

You should:

First - agree a Confidentiality Agreement (NDA) :
see 6 **How do I start negotiating a Joint Venture?**

Second - agree a Heads of Terms document:
see <https://www.thelegalpartners.com/Heads-terms-agreement-legal-advice-cfos>

Third - agree the Joint Venture Agreement
see: 14 **What legal agreements are needed to set up a Joint Venture?**

9 What is the Business of the Joint Venture ?

You and your Joint Venture partner should agree answers to these questions:

What will be the nature of the activities carried on by the Joint Venture ?

Is the purpose of the Joint Venture to carry out a specific project or a continuing business?

What is the likely turnover or market share?

Where will the business be based?

Will there be geographical limitations placed on the Joint Venture's operations?

What are the parties' objectives?

When do the parties want to exit and how?

What regulatory consents, approvals and licences will be required for the formation and business(es) of the Joint Venture ?

10 What is the best way to structure a joint venture?

Usually the JV parties form a separate limited company for the Joint Venture so each has limited liability (up to amount of share capital invested) should the Joint Venture not work and become insolvent.

However the tax position must be assessed to start with because transferring significant assets into the Joint Venture can have unwanted tax consequences. You should check with your tax advisers.

Sometimes a partnership or a limited liability partnership is used instead.

If you do not require management involvement in the Joint Venture, it may be best to use contractual arrangements rather than to create a separate Joint Venture entity. For example, a designer could simply license his or her intellectual property rights in the design to another business to exploit in return for royalty payments.

You should identify what other agreements are needed between the Joint Venture and the shareholders - eg licences to use software, brand names, premises, secondment of staff etc?

11 What about financing Joint Ventures

You and your Joint Venture partner will need to agree:

What proportion (if any) of the initial finance will the parties themselves provide and how much will be provided from external sources.

If third party funding is being sought, what security and/or recourse to the parties themselves will the lender(s) require.

Will the parties' initial investment be in cash and/or by contributing assets.

If the funding will be through debt rather than equity, or vice versa.

What arrangements will there be for funding, on a continuing basis:

the working capital requirements

losses incurred by the joint venture; and/or

development and expansion costs

Will each party be required (or entitled) to contribute to continuing calls for funding, pro-rata to its original investment or otherwise

What happens if one of the parties defaults.

12 What assets can be put into Joint Ventures?

Any asset can be put into a Joint Venture e.g. employees, intellectual property, offices, customers and suppliers and their related contracts.

Contributions can be by outright transfer, or by a lease or licence to the Joint Venture for a fixed or indefinite term. Separate documents will be required for the transfer of each asset to the Joint Venture .

The contributed assets will need to be valued and agreed with the Joint Venture partner.

You will need to agree if all contributions of assets can be made simultaneously, if you need any regulatory approvals or consents third parties (including lessors, licensors and lenders) or how required for any transfer. If not, the availability of all or any particular asset(s) can be a condition precedent to the establishment of the Joint Venture.

13 What due diligence is needed in Joint Ventures?

Due diligence will include checking:

your Joint Venture partner's legal status,

that they have the right to enter the Joint Venture,

that they own assets they will be putting into the Joint Venture

that they have enough funding to complete the Joint Venture

that they have the knowledge and experience you need for the market in which the Joint Venture will operate.

More broadly, due diligence aims to ensure that any agreements you enter into are valid, and to minimize risk of future legal problems. So,

14 What legal agreements are needed to set up a Joint Venture?

If you are forming a new Joint Venture company, a Joint Venture Agreement and the new company's articles of association are crucial. Points that may be covered in these documents or in separate agreements include:

the financing arrangements for the Joint Venture

agreements not to compete with the Joint Venture

arrangements for licensing or transferring intellectual property in inventions, brands, designs or copyright works such as plans or manuals to the Joint Venture

agreements on any services or supplies you will provide to the Joint Venture

confidentiality agreements

how any disputes will be handled

how the partners can exit the Joint Venture

any agreements that will continue after the Joint Venture is terminated.

15 What is a Shareholders Agreement?

A Shareholders Agreement can be another name for the Joint Venture Agreement. It sets out the agreement between the shareholders showing how they will operate the Joint Venture, how they will make decisions and vote as the shareholders and directors.

16 What are non-compete or non-competition or restrictions on Joint Venture parties?

These prevent the shareholder competing with the Joint Venture. The shareholders will need to agree answers to these questions:

Will the parties be prohibited from competing with the Joint Venture ? If so, what geographical or other limitations should apply?

Will the parties be prevented from soliciting customers and employees from the Joint Venture ?

How will the business of the Joint Venture be defined for the purposes of such restrictions?

Will the parties have obligations to refer business to the Joint Venture?

Usually the parties agree in the Joint Venture Agreement what restrictions apply to each of them, to prevent the scenario where the Joint Venture is set up and then the parties immediately compete against it.

17 What is the Board of directors in a Joint Venture?

The board of directors includes representatives of each Joint Venture partner. The Joint Venture Agreement will state:

What rights each party will have to appoint directors (and if the board or company in general meeting have rights to appoint any additional directors)

What quorum and notice requirements will apply for directors' meetings

What particular matters will be reserved for decision by the board itself (and be incapable of delegation) or to the shareholders?

What particular voting arrangements will apply to matters specifically reserved to the board and/or to any other matters

What will be the specific requirements concerning the frequency and/or location of board meetings

How the appointment of the chairman will be determined and if the chairman has a casting vote or not, or other special powers or rights

Who will determine the appointment of any managing or other executive directors

If the directors will have the power to resolve conflict, or potential conflict situations of a director or should such power be reserved for the shareholders.

18 What are the shareholders rights in a Joint Venture?

The shareholders will need to agree:

How will ownership of the Joint Venture will be divided and what voting rights the parties will have as shareholders

If there will be separate classes of shares – eg because each class of shares will have different ownership, dividends and or voting rights

If shares of the same class will be capable of being held by more than one person

If there will be any special voting rights attached to any or all shares

What quorum and notice requirements will apply for shareholder meetings

if there be any limitation on possible locations for shareholders' meetings

19 What is minority shareholder protection in a Joint Venture?

If a shareholder owns less than say 50% of the Joint Venture it may want to protect itself in the following circumstances:

The majority shareholder forcing through voting on certain important issues at shareholder meetings (e.g. changing the business, adding new shareholders, issuing new shares, buying new businesses or selling parts of the business)

Similar protections and any remedies can apply to board and/or director level voting as well.

20 What are restrictions on transfers of shares in the Joint Venture?

The Joint Venture parties will need to agree:

Should shares be transferable or not

What happens if any one party wants to sell out

If transfers are permitted, should other parties have pre-emption rights (rights of first refusal) before any sale to a third party takes place

To what extent will the identity of any third party purchaser be relevant to arrangements for permitting transfers or the terms of any pre-emption rights?

Should any transfers (for example, intra-group transfers or transfers to family trusts) be permitted free of pre-emption rights

Are any special terms appropriate, for example:

“shotgun” or “Russian roulette” provisions, by which other parties can elect either to purchase from, or to put their own shares on, an intending transferor; or

“drag-along” or “piggy back” (“tag along”) provisions, by which the intending transferor must endeavour to require a potential third party purchaser to acquire the other parties’ shares in addition to its own

How will shares be valued for the purposes of the transfer provisions

Will any new shareholder be required to become a party to the Joint Venture agreement

Will the Joint Venture’s name have to be changed if shareholdings are transferred

What will happen to any arrangements between a leaving shareholder and the Joint Venture (such as intra-group loans, intellectual property licences, supply agreements, management services, and so on)

It is common for shareholders to agree that shares may only be transferred in certain circumstances. If a shareholder wants to transfer shares it has to offer the shares first to the other shareholder(s) – this is called a pre-emption right. The shareholders will try and agree the price for the transfer of the shares. If they cannot agree on the price it is common for an independent valuer (accountant), experienced in valuing companies in their industry, to value the shares.

21 Can intellectual property be transferred to a Joint Venture?

Yes. A separate licence or transfer agreement will be agreed. The agreement will need to answer the following questions:

Are any intellectual property rights to be given to the other Joint Venture party?

Who will own the intellectual property rights developed by the Joint Venture and (if any) by the Joint Venture parties?

Who will undertake exploitation of the intellectual property, including both production and distribution? Will there be any compensation for this?

To what extent will the parties have access to, or rights over, confidential information, know-how and other intellectual property rights concerning or accruing or belonging to the Joint Venture itself?

What will happen to the intellectual property rights on termination of the Joint Venture?

Will any of the parties require a licence of any intellectual property from the other, following termination?

Will there be different methods of dealing with intellectual property rights depending on the exit route used?

22 Can Employees be transferred to a Joint Venture?

Employees can be transferred to a Joint Venture for a short term (secondment) or permanently. The parties will need to agree answers to the following questions:

Will the Joint Venture need employees and, if so, how will it get them?

Will the employees be seconded from any of the Joint Venture parties and, if so, will it be necessary to make any changes to the terms of their employment?

If the employees are to be transferred from any of the Joint Venture parties, will the [Transfer of Undertakings \(Protection of Employment\) Regulations 2006 \(TUPE\)](#) apply? If so, will it be necessary to make any changes to the terms of employment of the transferring employees? (It is only possible to make changes to the employees' terms on a TUPE transfer in certain circumstances.) How will any liabilities relating to the employees be apportioned? Will there be any consultation obligations? For further information on when TUPE applies, read www.thelegalpartners.com/transfer-undertakings-tupe-process-explained

If the employees are to be new recruits, are there particular individuals with key roles in the Joint Venture calling for special treatment?

Is any particular form of management structure envisaged?

What (if any) share option or incentive schemes are proposed?

What pension arrangements will apply?

Will any of the Joint Venture parties have to make redundancies as a result of the creation of the Joint Venture? If so, how will the cost be borne by the parties?

23 Can the shareholders continue to provide assets or services to the Joint Venture?

Yes. The parties will agree the answers to these questions:

Will any of the parties second staff to the Joint Venture and, if so, on what terms? (Read over **Can Employees be transferred to the Joint Venture?** above)

Will any of the parties be responsible for providing the Joint Venture with office or other accommodation, support services or facilities, or training for staff?

Will there be continuing trading arrangements between any of the parties and the Joint Venture (for example, distributorship agreements or agreements for the supply of goods, materials or services)? If so, will these be independently audited?

How do continuing arrangements between the Joint Venture and any of the parties impact on:

the entitlement of each of the parties to the profits of the Joint Venture, or responsibility for its losses?

the business risks and legal liabilities assumed by each of the parties in relation to the Joint Venture?

the rights of the Joint Venture and/or the parties to assets or revenues over which any one party maintains

direct control or ownership?

What will be the procedure for the flow of information and for reporting from the Joint Venture to the parties?

24 How do I terminate or end a Joint Venture?

The parties can agree to end the Joint Venture either by following the process they have agreed in the Joint Venture Agreement or by agreeing a new procedure. It is important to agree:

Is the Joint Venture for a fixed term or indefinite in duration?

Are there any circumstances in which the Joint Venture will automatically terminate, for example:

the loss of any regulatory approval;

the loss or destruction of a particular asset;

the insolvency of any party;

loss of software licence; or

the transfer of any party's shares?

Are there any circumstances in which any party will be entitled to terminate the Joint Venture, for example:

a change of control of any other party;

a material breach of the Joint Venture agreement by another party;

by notice of termination given after the expiry of a minimum fixed term?

What arrangements will apply on termination for:

the distribution of the assets, including intellectual property and know-how of the Joint Venture ;

the discharge of outstanding contracts of the Joint Venture; and

the assumption or discharge of any other liabilities of the Joint Venture?

Usually, one partner will buy out the other. The key is to plan for the termination of the Joint Venture from the outset. For example, the original agreement can include provisions that allow you to force your partner either to sell you their stake or to purchase your stake from you.

25 How do we take profits from the Joint Venture?

Profits from Joint Venture companies are commonly distributed through dividends.

Of course, the ability of the Joint Venture to pay dividends will depend on its cashflow position. Depending on the circumstances, there may also be other more tax-effective ways of realizing part of the value of your investment in the Joint Venture. Where a Joint Venture is structured as a partnership, profits are automatically shared between the partners as specified in the partnership agreement. The partnership agreement should also specify what cash payments partners can take from the partnership. If there is no separate joint venture entity, there will be no need to 'take' profits from the joint venture - the profits will in any case arise within your (or your Joint Venture partner's) business.