Joint Ventures 2021

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LEXOLOGY
Getting The Deal Through

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Frost Brown Todd LLC

Lexology Getting The Deal Through is delighted to publish the fourth edition of *Joint Ventures*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Russia, South Korea and Taiwan.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Kai Bitter, Kristen A Elia and Emily Tanji of Frost Brown Todd LLC, for their continued assistance with this volume.

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United States

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FORM

Types of joint venture

1 | What are the key types of joint venture in your jurisdiction? Is the 'joint venture' recognised as a distinct legal concept?

Delaware is one of the few states that specifically addresses joint ventures in its corporate code. It refers to joint ventures as corporations with two stockholders each holding 50 per cent of the stock therein. Typically, though, the term 'joint venture' is used more broadly to describe a business venture established for a specific purpose by usually two (and sometimes more) independent parties that want to combine their technology, research and development capabilities, distribution channels, market access, financing or other resources. The basis for these collaborations can be contractual, often in the form of complex commercial arrangements that go well beyond customary supply and service agreements, also referred to as strategic alliances. Alternatively, the parties may collaborate in a jointly owned entity that is either specially formed for the joint venture or results from an investment by one joint venture party into the other.

Common sectors

2 | In what sectors are joint ventures most commonly used in your jurisdiction?

In the United States, joint ventures are used across a broad array of sectors. Increasingly, they have been used in the automotive, energy, oil and gas, healthcare, technology and biotechnology industries. There are no geographic or industry-specific restrictions limiting joint ventures. The parties' choice to enter a contractual joint venture or form an entity joint venture is largely driven by their overall business objectives rather than the sector in which the parties operate; the parties' objectives may include the desire to jointly develop IP or to enter new markets with a partner already familiar with that particular market.

PARTIES

Rules for foreign parties

3 | Are there rules that relate specifically to foreign joint venture parties?

Neither the corporate and limited liability company (LLC) laws that apply to entity joint ventures nor the commercial rules or common law that apply to contractual joint ventures distinguish between domestic and foreign joint venture parties. However, there can be significant differences: from a tax perspective, choosing the entity form of a corporation (and not an LLC) for a joint venture avoids pass-through tax treatment and thus shields the foreign joint venture party from US federal income taxation and related income tax filing requirements. Export control regulations may prohibit the disclosure of certain information to the foreign joint venture party and its representatives. There can also be differences in industry-specific regulations, such as those stipulated by the Federal Communications Commission regarding foreign ownership of common carrier and other licences under the Communications Act of 1934. Another key area is the review by the Committee on Foreign Investment in the United States, which may review the impact of certain joint ventures with foreign joint venture parties on matters of national security.

Ultimate beneficial ownership

4 | What requirements are there to disclose the ultimate beneficial ownership of a joint venture entity?

Most states do not require the ultimate beneficial owners to be disclosed upon formation of the entity joint venture. Exceptions apply when the beneficial owners manage the business, as many governmental agencies require the disclosure of the directors and officers of a corporation and managers of an LLC. Additionally, the Bureau of Economic Analysis of the US Department of Commerce (BEA) mandates disclosure of foreign investment, which disclosure requires certain beneficial owners, generally foreign persons that own 10 per cent or more of the voting securities in a US business enterprise, to be identified. However, the data collected by the BEA is not made available to other government agencies but is instead used solely for analytical and statistical purposes to track foreign direct investment and international trade.

SETTING UP AND OPERATING A JOINT VENTURE

Structure

5 | Are there any particular drivers in your jurisdiction that will determine how a joint venture is structured?

The choice between an entity joint venture and a contractual joint venture largely depends on the parties' contributions and objectives. For example, contractual joint ventures usually do not provide for jointly owned assets, whereas entity joint ventures are legally separate from their owners, own their assets, and provide for a well-developed governance structure. For entity joint ventures, both corporations and limited liability companies (LLCs) provide their owners with a liability shield and other protections, including fiduciary duties for directors, officers, managers and potentially the owners themselves, and certain procedural requirements before the entity joint venture can be dissolved. For joint ventures with foreign joint venture parties, the LLC may lead to adverse tax consequences, so the corporation may be the better entity form. But with any entity form, the joint venture parties typically have great freedom in structuring their relationship as most requirements under corporate and LLC laws are not mandatory and thus only apply if the parties do not agree otherwise. Given that LLCs provide essentially the same benefits as general and limited partnerships from a structuring and tax perspective, but also limit their owners' liability, general and limited partnerships have become almost irrelevant for joint venture purposes.

Tax considerations

6 | When establishing a joint venture, what tax considerations arise for the joint venture parties and the joint venture entity? How can tax charges be lawfully mitigated?

The tax considerations that arise for entity joint ventures depend on the form of entity chosen. For domestic joint venture parties, LLCs tend to be the most tax-efficient entity form as it provides for partnership taxation, so that profits and losses generally flow through to the joint venture parties. Forming the joint venture as a corporation may create tax inefficiencies: the income of the corporation is generally subject to taxation at the level of the corporation and also at the level of the joint venture parties when distributed, and the dividends received deduction only partially deducts the double taxation. Also, a joint venture party cannot consolidate its taxes with the corporate joint venture unless it owns 80 per cent or more of the joint venture, and losses incurred by the joint venture are therefore trapped at the joint venture level.

Foreign joint venture parties should pay particular attention to permanent establishment rules and tax treaties with the United States when assessing US tax liability. There are also special considerations in determining the tax filing requirements of foreign joint venture parties: if an entity joint venture is taxed as a partnership (which is the default for LLCs), the taxes will pass through the entity joint venture to the foreign joint venture party, and the foreign joint venture party becomes a US taxpayer. This can be avoided by having the LLC elect to be treated as a corporation for tax purposes. However, some non-US countries do not accept the hybrid nature of the LLC and tax it as a partnership, even if it chooses to be taxed as a corporation in the United States. To avoid complications and potential tax inefficiencies, joint ventures with foreign joint venture parties are therefore often formed as a corporation.

Asset contribution restriction

7 | Are there any restrictions on the contribution of assets to a joint venture entity?

There are no restrictions on contribution of assets. Apart from cash, the joint venture agreement may provide for the contribution of tangible personal property (eg, production equipment) or intangible assets (eg, intellectual property). The joint venture parties may even agree to only contribute (future) services, provided, however, that for corporate joint ventures, a contribution may be taxable if more than 20 per cent of the stock in the joint venture is issued solely for services.

Interaction between constitution and agreement

8 | What is the interaction between the constitution of the joint venture entity and the agreement between the joint venture parties?

The formation of an entity joint venture in the form of a corporation or an LLC typically only requires the filing of very generic and limited information. The agreements that typically govern the joint venture (the shareholder agreement for corporations and the operating agreement for LLCs) are not filed publicly. These agreements may not contradict the formation documents, but contradictions are rare since formation documents only provide very limited information. To a limited extent, applicable corporate or LLC laws will stipulate mandatory requirements that take precedence over any agreement between the joint venture parties (eg, many states do not permit a complete waiver of the fiduciary duties). But, otherwise, the joint venture parties have great flexibility in structuring their relationship.

Party interaction

9 | How may the joint venture parties interact with the joint venture entity? Are there any restrictions?

If the joint venture is in the form of a corporation, state laws govern the role of each corporate actor: shareholders are the owners of the corporation and elect the members of its board of directors at the annual shareholders' meeting. Apart from appointing the board, the powers of the shareholders are quite limited because the board is not subject to the shareholders' directions. It is the board that sets the strategy and budget and appoints the officers, whose role is to execute the board's decisions and run the day-to-day business. Each joint venture party typically designates a certain number of individuals to the board. These individuals are subject to fiduciary duties, which in particular require them to act in the best interests of the joint venture.

If the joint venture is formed as an LLC, the joint venture is governed by its members or by managers appointed by the members. Often, the joint venture parties will set up a governance structure that resembles that of a corporation, by providing for a board and officers. The persons acting on behalf of the joint venture owe fiduciary duties of loyalty and care to the LLC and its members. State laws typically allow the joint venture parties to modify the fiduciary duties of the persons managing or operating the entity joint venture, provided, however, that many states impose minimum requirements from which the parties may not deviate.

The governing documents of an entity joint venture typically provide for various actions that require the prior approval by the board or owners. Such actions usually include material changes to the joint venture's business, issuance of additional ownership interests or admission of additional joint venture parties, taking on debt, appointing auditors, entering into related party transactions and other key matters. These actions may also be subject to different approval thresholds (ie, supermajority or unanimity).

The governing documents should also provide for inspection rights and regular reporting to the joint venture parties and require the joint venture parties to treat such information confidentially.

Exercising control

10 | How may the joint venture parties exercise control over the joint venture entity's decision-making?

For entity joint ventures, the joint venture parties' governance rights are based on the corporate or LLC laws of the state in which the joint venture is formed. State laws typically provide a minority investor with some minimum level of protections, but allow investors to deviate substantially from the statutory rules to modify these minority rights. Apart from these statutory protections, the joint venture parties typically address the governance structure in the shareholder or operating agreement. Generally, key negotiation points are board representation, approval requirements for material transactions and veto rights, inspection rights regarding the books and records of the joint venture, and preemptive rights regarding any future equity issuances. As an extraordinary remedy to enforce these rights, minority shareholders and LLC members may protect their rights and impact the joint venture's decision-making through derivative actions. A derivative action is a mechanism under state law by which a joint venture party as a shareholder of a corporation or member of an LLC, on behalf of and for the benefit of the entity joint venture, can take legal action against the members and managers of LLCs and directors and officers of corporations that may have harmed the entity joint venture.

Governance issues

11 What are the most common governance issues that arise in connection with joint ventures? How are these dealt with?

Successful management and operation of a joint venture is a difficult undertaking. Many joint ventures require continuous support, including funding, from the joint venture parties, at least during the initial years. Often, the joint venture parties (or their nominees to the board) had not worked with each other before the joint venture was formed and thus struggle to collaborate effectively. This level of interdependency usually necessitates a governing body that sets the strategy and budget and provides for transparency. With or without such a governing body, many joint ventures encounter a variety of governance issues: the objectives of the joint venture parties are or become incompatible or a joint venture party might try to micromanage the joint venture's management. A joint venture party's compliance requirements might use up significant resources of the joint venture, which is particularly problematic when a publicly traded company wants to collaborate with a start-up business. Or the joint venture parties might disagree on the use of available cash-flow (ie, distributing it to the joint venture parties versus reinvesting it into the joint venture for future growth). To reduce the risk of frustrated expectations and misalignment, the joint venture parties must ensure that the joint venture agreement properly reflects their objectives, stipulates approval and reporting requirements for the joint venture management's authority and responsibility, and outlines the level of desired and necessary involvement of the joint venture parties.

But even with a well-developed joint venture agreement, disagreements cannot always be avoided. The joint venture agreement therefore needs to provide for an adequate dispute resolution mechanism to ensure that the joint venture can overcome such disagreements. These mechanisms often include an escalation process where the governing body of the joint venture can require senior management from both joint venture parties to become involved to resolve a disagreement. If that fails, the joint venture agreement typically provides for arbitration (sometimes preceded by mediation), which many investors prefer over litigation in US courts.

A deadlock of the joint ventures' management or ownership is a common problem for joint ventures. In 50/50 entity joint ventures, all decisions beyond the day-to-day require unanimous approval by the joint venture parties (or their designees to the board). In joint ventures with a majority joint venture party, the minority party typically demands significant supermajority requirements or veto rights for its protection. In either instance, if the joint venture parties are unable to agree on a matter critical to the joint venture's business, the joint venture becomes deadlocked, which – if not resolved quickly – causes many joint ventures to fail. For these instances, the governing documents of entity joint ventures often provide for buy/sell rights. These rights allow each joint venture party to buy or sell its ownership interests in the event that the parties are unable to resolve a deadlock. A common buy/sell provision is known as Russian Roulette, which allows a joint venture party to name a price at which the other joint venture party may either buy the offering joint venture party's ownership interest or sell its own. Contractual joint ventures, on the other hand, often provide for termination rights that allow either joint venture party to exit the joint venture if it is unable to carry on the business for which it was formed.

Nominee directors

12 With an incorporated joint venture, what controls exist in your jurisdiction in relation to nominee directors? How should a nominee director balance the potentially conflicting interests of the joint venture company and the appointing shareholder?

State laws and the governing documents of entity joint ventures set forth the roles, duties and powers of directors and officers. The board of directors is the main governing body of a corporation (and of LLCs if the operating agreement so provides). The board meets regularly to set the strategy, approve the budget and oversee the officers, who are responsible for carrying out the board's policies and making the day-to-day decisions. Directors and officers generally owe fiduciary duties to the joint venture and the joint venture parties, which prohibit a director or officer from acting in only one joint venture party's interests. If there is a conflict of interest, the director is typically required to disclose such conflict and obtain approval from a disinterested majority of directors or by shareholders' vote. To prevent these foreseeable conflicts of interest, joint venture parties often modify or even waive the fiduciary duties of the directors and officers in the joint venture agreement (to the extent to which fiduciary duties can be waived, which varies by state).

Competition law

13 What competition law considerations are engaged by the formation and operation of the joint venture? Is approval needed?

For any joint ventures (ie, whether the joint venture parties combine all their resources and efforts in a particular area (comprehensive joint venture) or continue to compete with the joint venture and each other (partial joint venture)), the principal antitrust concern is about the degree of market concentration created by the joint venture. A partial joint venture, however, creates additional concerns from an antitrust perspective, mainly with respect to the sharing of competitive information, the coordination among the joint venture and the joint venture parties and price fixing. The federal and state antitrust laws apply to both entity joint ventures and contractual joint ventures. Antitrust risks heighten where joint venture parties dominate in their particular markets, where joint venture parties are competitors and are sharing competitively sensitive information, or where joint ventures eliminate competition between joint venture parties and their combined market share is greater than 20 per cent. In the context of a merger, depending on the size of the parties and transaction, the Hart-Scott-Rodino Antitrust Improvements Act of 1976 may require pre-merger notification to the Federal Trade Commission and Department of Justice. The National Cooperative Research and Production Act of 1993 provides particularly favourable antitrust treatment to joint ventures established for joint research and development activities as long as they comply with its various restrictions.

Provision of services

14 What are the key considerations in your jurisdiction in structuring the provision of services to the joint venture entity by joint venture parties?

For entity joint ventures, a party may provide services either at a charge or as a contribution to the joint venture. A joint venture party's services are often critical to the success of the joint venture and thus require extensive negotiations. Any services agreement entered into between the joint venture and a joint venture party subsequent to the formation of the joint venture constitutes a related party transaction and is thus subject to the conflicts of interest rules of the relevant jurisdiction in which the joint venture is formed. These rules usually require related party transactions to be on arm's-length terms. To avoid this conflict, the joint venture parties could waive all fiduciary duties, including the duty of loyalty. From an antitrust perspective, the joint venture parties, if they are competitors, need to be careful about not disclosing any cost information when providing these services. For contractual joint ventures, the joint venture parties typically do not need to observe the usual standards of fairness, as courts generally do not scrutinise the fairness of arm's-length transactions.

Employment rights

15 What impact do statutory employment rights have in joint ventures?

An employee seconded by a joint venture party to the joint venture may retain his or her employment relationship with the joint venture party and, at the same time, enter into an employment relationship with the joint venture. If the two employers operate in different jurisdictions (even different US states), the employee will likely benefit from statutory protections in both jurisdictions (eg, protections against dismissal and restrictions on noncompetition obligations). If the joint venture party and the joint venture provide different benefits to their respective employees, the employee may be able to argue that he or she is entitled to the more favourable benefits. Also, the seconding joint venture party may remain vicariously liable for the acts of the employee (and the joint venture agreement should provide for indemnification of the seconding joint venture party as long as the employee acts within the scope of his or her employment for the joint venture).

Intellectual property rights

16 How are intellectual property rights generally dealt with on the creation, operation and termination of a joint venture in your jurisdiction?

The contribution of intellectual property to a joint venture is often a key reason for the joint venture's formation. Also, the sharing of R&D resources to develop IP is another reason for which joint ventures are often formed. IP contributed to or developed by the joint venture is typically an asset of the joint venture. Upon its dissolution, the IP will be sold together with the joint venture's other assets, unless the joint venture parties agree otherwise. To avoid the loss of the IP in this instance, many joint venture parties only license their IP to the joint venture, so as to retain ownership if the joint venture fails. For contractual joint ventures, IP ownership needs to be addressed in the joint venture agreement and is otherwise based on US intellectual property laws.

FUNDING THE JOINT VENTURE

Typical funding

17 How are joint ventures generally funded in your jurisdiction? Are there any particular requirements relating to funding and security packages?

There are no specific requirements for funding joint ventures. Entity joint ventures can be formed by cash contributions, contributions in kind, the promise of future contributions and the contribution of services, including future services. Typically, joint venture parties contribute capital to the joint venture in exchange for shares or units in the entity joint venture. These contributions create the parties' basis in the joint venture for tax purposes and may impact the way the entity joint venture issues distributions to the joint venture parties. The parties may also contribute capital through loans made to the entity joint venture. These loans will often contain standard credit terms, including default provisions, calculation of interest and maturity dates. In lieu of repayment of these loans, the joint venture's operating documents may allow the loaning party to convert the loan into additional equity in the joint venture.

Contractual joint ventures will stipulate each party's performance obligations, which might include financial or other contributions (including services) to each other, often in return for a portion of the venture's profits.

Capital injection restrictions

18 Are there any legal or regulatory restrictions on the injection of capital into, or the distribution of profits or the extraction of cash by other means from, the joint venture entity?

For corporate joint ventures with par value shares, the contributions must at least equal the nominal value of the shares. Corporate joint ventures may also be formed with no par value shares. For those, and for limited liability companies (LLCs), the consideration to be contributed by the joint venture parties either needs to be stipulated in the governing documents or determined by the board of directors or managers.

Cash is usually extracted from joint ventures through dividends, interest or royalty payments, management fees, or other service fees. Corporate laws typically limit dividends to the surplus or net profits of a corporation. LLC laws typically provide that the effect of any distribution may not cause the liabilities of the LLC to exceed the fair market value of its assets. Tax considerations often influence the method of extracting cash, particularly for joint ventures with foreign joint venture parties that are subject to transfer pricing requirements.

Tax considerations

19 What tax considerations should be taken into account in the operation of the joint venture?

An entity joint venture in the form of an LLC is typically more tax efficient and flexible than a corporation, as the LLC is treated as a partnership for tax purposes. However, because the owners of an LLC are taxed on their share of the joint venture's income, they may have to pay taxes even if there is no distribution (phantom income). Therefore, the joint venture typically distributes at a minimum an amount equal to the joint venture parties' tax liability. Also, foreign joint venture parties will be subject to US federal income taxes and related income tax filing requirements.

If, on the other hand, the joint venture is formed as a corporation, the (domestic or foreign) joint venture parties are only taxed if the joint venture pays a dividend. However, a joint venture party cannot consolidate its taxes with the corporate joint venture unless it owns 80 per cent or more of the joint venture, and losses incurred by the joint venture are therefore trapped at the joint venture level.

Accounting and reporting issues

20 Are there any noteworthy accounting or reporting issues for the joint venture parties regarding their investment in the joint venture?

The most noteworthy accounting and reporting issues apply to joint ventures with foreign joint venture parties.

Typically, the owners ('members') of an LLC have great flexibility in determining how to allocate profits and losses between them. The most significant accounting and reporting issue that a potential foreign joint venture party should be aware of is that an LLC, or its withholding member, is required to pay a withholding tax on the effectively connected taxable income that is allocable to its foreign members. The rate of taxes the LLC is required to withhold will depend on whether the foreign member is itself a corporation. The withholding tax rate for effectively connected income allocable to non-corporate foreign members is 37 per cent, and 21 per cent for corporate foreign members.

Additionally, foreign investors investing in US entities, whether directly or indirectly, are required to file a report with the US Commerce

Department's Bureau of Economic Analysis. Reporting requirements are triggered by the acquisition of 10 per cent or more of the voting interests in a US entity, whether those interests were acquired through investing in an existing US business; acquiring an existing US business; forming a new entity; acquiring a US business that merged into an existing US affiliate of a foreign entity; expanding an existing US affiliate of a foreign entity.

DEADLOCK, EXIT AND TERMINATION

Deadlock provisions

21 What deadlock provisions are commonly included in joint venture agreements in your jurisdiction?

There are a wide variety of deadlock provisions used by joint venture parties. Typically, the deadlock provision escalates a dispute by involving senior management of both joint venture parties or independent board members of the joint venture, following by mediation, arbitration or both. As a last resort for joint venture entities that are unable to resolve their deadlock, deadlock provisions may provide for the exit of one of the joint venture parties by selling its ownership interest to the other joint venture party or a forced sale of the entity joint venture, at least for certain fundamental disagreements specified in the joint venture agreement. A popular mechanism for an exit is the Russian Roulette provision, which allows each joint venture party to name a price at which the other joint venture party can sell its ownership interest to the offering joint venture party or buy the offering joint venture party's ownership interest (with the relevant purchase price being proportionate to the ownership interest that is being sold). If all else fails, the joint venture agreement typically provides for the dissolution of the entity joint venture upon the joint venture parties' approval. Contractual joint ventures usually provide for an escalation procedure that involves senior management, followed by mediation, arbitration or both, and often permit each joint venture party to terminate the joint venture if the deadlock cannot be resolved.

Exit provisions

22 What exit provisions are commonly included? Does the law restrict any forms of mandatory transfer provision or any basis of calculation?

Broadly speaking, there are two categories of exit plans for entity joint venture parties. The first is a joint venture party's sale of its interests in the venture. The governing documents of most joint venture entities allow for a sale of a joint venture party's interest to the joint venture or the other joint venture party. But they often prohibit the sale to a third party or at least stipulate a right of first refusal, as joint venture parties typically want to be able to control with whom they partner in the joint venture. Additionally, the governing documents of an entity joint venture may grant parties tag-along rights or drag-along rights. The drag-along mechanism protects the majority by forcing the minority to sell its ownership interest if the majority secures a buyer for its own interests, thereby facilitating the sale of the entire entity. Tag-along rights flip this scenario and protect the minority by allowing it to require the majority to include the minority in a sale.

The second category is the sale or termination of the joint venture as a whole. The parties may choose to sell the entity to a third party, issue an IPO or dissolve the entity joint venture. The governing documents may provide for a liquidation preference upon a dissolution so that certain assets that were contributed by a joint venture party when the joint venture was formed (eg, intellectual property) is returned to the contributing joint venture party. Dissolution is not usually favoured, for the process of determining which assets belong to which joint venture party can be contentious.

For entity joint ventures, there may be bankruptcy or regulatory laws that exclude certain exit options or types of equity transfers.

For contractual joint ventures, the alliance between the contracting parties is not intended to last forever. Also, because general contract rules apply to the joint venture agreement, the joint venture parties may include a wide variety of termination or exit procedures. The joint venture parties will typically stipulate a termination date and may include provisions allowing each party to terminate the agreement early (ie, upon the insolvency of a party, if one party materially breaches the agreement, or if the joint venture cannot effectively carry out the purpose for which it was formed, if the parties become deadlocked).

Tax considerations following termination

23 What are the tax considerations on termination of the joint venture?

The tax considerations on the termination of the joint venture will depend on the method of termination. In the liquidation and winding up of the joint venture, parties typically receive cash and property.

As general matter, if the joint venture is taxed as a partnership, there is no tax to the joint venture or the joint venture parties on the distribution of assets. The joint venture parties take a basis in the assets distributed to them equal to the basis they had in the joint venture. The rules get more complicated if a joint venture party has a negative capital account. In that case the joint venture party will recognise gain equal to the negative balance in its capital account. Added complexity arises if a joint venture party does not receive its appropriate share of assets that produce ordinary income when sold, which typically does not happen. If the joint venture is a C corporation (ie, subject to tax at both the corporate and shareholder levels), it will be taxed on the distribution of appreciated assets in the process of winding up its business. Additionally, the corporation's shareholders will recognise gain on their shares when they receive liquidating distributions; this results in double taxation for the shareholders.

DISPUTES

Choice of law and resolution methods

24 In your jurisdiction, are there constraints on the choice of law or the method of dispute resolution provided for in joint venture agreements?

For entity joint ventures, the joint venture parties can decide freely in which state they form the joint venture as a corporation or limited liability company (LLC), and the corporate or LLC laws of such state will apply to the joint venture. Parties entering into a contractual joint venture are also generally free to choose the law that applies to the joint venture, provided that courts may decide not to enforce such governing law provision if neither the joint venture nor its parties have any connection to the state whose law was chosen.

Mandatorily applicable local law

25 What mandatory provisions of local law will apply irrespective of the choice of governing law?

For joint venture entities, the corporate or LLC code of the entity's state of formation will apply to its operations. Compared to many other jurisdictions, corporate and LLC laws throughout the United States grant the parties a great deal of flexibility in structuring the corporation or LLC. Although the entity's governing documents can largely dictate its structure and rules for operations, certain mandatory provisions of the state's corporate or LLC code cannot be waived. One important example of this is a state's fiduciary duty requirements. Many states allow the parties to strictly curb, or entirely do away with, certain fiduciary duty obligations, but some states (including Delaware) prohibit the joint venture entity from waiving the fiduciary duty of good faith and fair dealing.

In the case of both contractual and entity joint ventures, although a court in one jurisdiction will apply the laws of another jurisdiction, as specified in the parties' choice of law clause, that court will still apply its own procedural rules. Similarly, it will apply its own laws determining what qualifies as procedural and what qualifies as substantive law. Furthermore, local laws, such as licensing, zoning and registration, will also apply in regard to the joint venture's operations.

Remedy restrictions

26 Are there any restrictions on the remedies a tribunal can grant that would have a bearing on the arbitration of joint venture disputes? Are there any restrictions on the arbitration of shareholder claims?

There are no statutes restricting the remedies a tribunal may grant in a joint venture dispute. The joint venture parties themselves, however, often restrict the remedies they may seek against each other. For example, joint venture parties often waive indirect and consequential damages as well as lost profits (and instead rely on the exit or termination provisions). Restrictions typically do not prohibit, or specifically allow for the parties to seek injunctive relief, often a more effective remedy, as it is both easier and quicker to receive and courts have broad latitude to craft efficient solutions.

Minority investor protection

27 Are there any statutory protections for minority investors that would apply to joint ventures?

For joint venture entities with a minority joint venture party, minority protections typically take a central role in negotiating the joint venture structure. The corporate and LLC codes of certain states protect minority investors. For example, in the context of a corporation's freeze-out or squeeze-out merger, whereby two corporations are merged into one and the minority joint venture party is forced to sell its interests as part of the transaction, state corporate laws often require the majority joint venture party to pay the minority joint venture party a fair value cash buyout. In Delaware, for example, the minority joint venture party has the right to have its interests appraised to ensure that it receives a fair price.

However, because state rules can often be limited or waived by the joint venture parties, the minority member joint venture party often seeks not only to keep statutory protections in place, but also to include additional protections. Some additional minority protections include:

- supermajority requirements or veto rights for certain actions, which prevent the majority joint venture party or the joint venture's management from making certain decisions without the minority's approval. For example, Delaware requires the vote of a majority of outstanding shares to approve a merger, while Ohio requires a vote of two-thirds of the outstanding shares (but allows the articles to stipulate a different proportion not less than a majority);
- the right to appoint one or more board members. If the minority member cannot obtain a board seat, it should seek observer rights allowing it to designate a person to observe board meetings and stay appraised of the entity's actions;
- the ability to require the majority member to purchase the minority's interest in certain situations, such as a change of control of the majority party (known as a put option or put right); and
- tag-along rights, which allow the minority joint venture party to sell its interests on a pro rata basis should the majority joint venture party seek to sell its interests to a third party.

Liabilities

28 How can joint venture parties have liabilities to each other beyond what is expressly agreed in the joint venture agreement?

The joint venture parties can incur obligations to each other in several ways. In some instances, the law treats a joint venture much like a partnership (ie, certain cases have applied the partnership rules of joint and several liability to a joint venture), and with that can come the general principles of partnership and agency law. Within the scope of the joint venture's operations, certain states may treat one joint venture party as principal for itself and as agent for the other party and can thus find that one party's actions bind the other. Because of this, the parties should be mindful in drafting the entity joint venture's organisational documents to limit the scope of each party's authority and clarify that the parties are not each other's agents.

With joint venture entities, majority owners and nominee directors to the board of directors have fiduciary duties to the corporation. In certain states, majority joint venture owners owe limited duties (typically in the context of a sale of the entity joint venture) to the minority owner. Directors and officers generally owe fiduciary duties to and must act in the best interests of the joint venture and the joint venture parties, and may not act only in one joint venture party's interests. Directors and officers may be held liable to the corporation for acting under a conflict of interests to the detriment of the joint venture.

With contractual joint ventures, general contract principles apply, including the implied duty of good faith and fair dealing that all contractual parties owe to each other. This duty typically arises when one party to a contract has a discretionary right to do something and exercises that right in bad faith, to the detriment of the other party. In addition, a claim for fraud brought by one joint venture party may also create liability for the other joint venture party, even if there are contractual carve-outs excluding such claims.

Disclosure of evidence

29 Are there any particular issues that can arise in joint venture disputes in your jurisdiction concerning disclosure of evidence?

Unlike in many jurisdictions, the United States allows for broad discovery of evidence. With limited exceptions, parties can request any documents containing relevant information or which may lead to the discovery of relevant information. Joint venture parties often provide for dispute resolution by arbitration with express restrictions on the scope of discovery to avoid the often unduly burdensome discovery process in the United States.

Joint venture parties may encounter issues related to attorney-client privilege. Some courts have applied the 'common interest privilege' to collaborative business ventures, like joint ventures. The common interest privilege is an extension of the US's attorney-client privilege and it protects communications passing from one party to the attorney for another party. Importantly, for the privilege to apply, the parties must have a common interest and that interest must be legal in nature. When the joint venture parties are in a dispute between themselves, the privilege is unavailable. Thus, in general, parties to a US joint venture should assume that most information will be discoverable in litigation.

MARKET OVERVIEW

Jurisdictional advantages

30 What advantages does your jurisdiction offer for parties wishing to set up and operate joint ventures?

The key advantage of the United States is the flexibility it affords. It is a freedom of contract jurisdiction and, with few exceptions, the parties are free to structure and manage an entity joint venture or contractual joint venture as they see fit. The United States affords several entity forms to choose from to achieve the parties' specific goals for the venture and their formation is usually simple and quick. US courts typically enforce the (unambiguous) terms of the joint venture agreement as written. Additionally, foreign investors are largely subject to the same rules as domestic parties.

Requirements and restrictions

31 Are there any particular requirements or restrictions relating to joint ventures in your jurisdiction that could deter international investors?

Typically, the most significant deterrent to international investors is US litigation, which is notoriously lengthy, expensive and, for parties unused to US discovery rules, invasive. For this reason, foreign investors should properly draft the dispute resolution mechanism when forming the joint venture. Such a mechanism should avoid litigation in US courts to resolve disputes between the joint venture parties and instead provide for arbitration, possibly preceded by mediation.

Although not necessarily a deterrent, foreign investors should also be aware of the reporting requirements of the Bureau of Economic Analysis, which may be triggered by the foreign investor's activities in the United States, and the possibility that the Committee on Foreign Investment in the United States may examine the investor's activities.

UPDATES & TRENDS

Key developments of the past year

32 What are the current trends affecting joint ventures in your jurisdiction? What recent developments in legislation and case law have had an impact on joint ventures?

On 6 August 2020, President Trump issued an executive order giving the Chinese company ByteDance 90 days to sell the popular video-sharing app TikTok. The President's authority for this executive action derives from the Committee on Foreign Investment in the United States (CFIUS), which has the power to unwind or block deals involving foreign investors. The committee was relatively unknown (even in legal and political circles) until recently, but has taken on a new significance under the Trump Administration. Originally formed to review transactions with an eye on US national security, its scope of review has recently been expanded to include a broader focus on the economic implications of individual foreign investment transactions and the cumulative effect of foreign investment on certain sectors of the economy or by investors from certain countries. CFIUS is not required to provide data about its activities, making it impossible to know the precise number of CFIUS filings that have been made since the change in law. However, it is clear that CFIUS has been more active in the past few years. Foreign investors interested in entering the US market should continue to monitor CFIUS's activities – to the extent they are made public.

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Coronavirus

33 What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

The most prominent emergency legislation in response to the coronavirus pandemic in the United States is the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which aims to provide economic relief to small businesses, American industries, and more. The CARES Act provides certain tax benefits to businesses and includes the Paycheck Protection Program, which administers forgivable loans to fund payroll and certain overhead expenses of small businesses (companies with 500 employees or less). In addition, the Families First Coronavirus Response Act, as amended and clarified by the CARES Act, significantly expands the reach of the Family Medical Leave Act with regard to paid sick leave and family leave in connection with covid-19.

Individual states have also taken steps to address concerns related to the pandemic. For example, Ohio has adopted legislation that bars civil actions for injury, death, or loss caused by exposure to, or transmission or contraction of covid-19 or any mutation of the virus, where it cannot be established that the exposure, transmission or contraction was caused by reckless conduct or intentional, wilful or wanton misconduct by the person who is being sued.

There continue to be new legal developments and guidance issued in connection with the pandemic. It remains particularly important to keep up to date in areas of tax and employment, and with relevant loan programs and developments in the relevant state.

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