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JONES DAY®

Joint ventures in Germany

BY MARTIN KOCK AND MARTIN SCHULZ

There are numerous economic reasons for the establishment of joint ventures. They may help penetrate new or consolidate existing markets, or minimise costs and risks for the development of new products. These economic drivers are no different in Germany than anywhere else. However, setting up a successful joint venture in Germany requires understanding certain legal specifics. Some of the most relevant are highlighted in this article.

Formation of a joint venture

German joint ventures are mostly established either in the form of a limited liability company or a limited partnership (with the sole general partner being a limited liability company). Stock corporations are hardly used as they are too complex, and the ability of the parties of the joint venture to control the stock corporation's management is limited. However, if the parties plan to list the joint venture in the foreseeable future, a stock corporation might be the appropriate choice.

Whether the parties should use a limited liability company or a limited partnership as the joint venture vehicle depends to a large extent on tax considerations, as corporations and partnerships are taxed differently in Germany. Issues to be considered in this respect include: (i) when and to what extent is the joint venture expected to generate profits; (ii) whether profits shall be retained or distributed; (iii) the legal form and nationality of the parties to the joint venture; (iv) whether and in what form it is planned to exit the joint venture, in particular whether it is planned to sell the shares / interest in the joint venture.

If a party transfers an existing business to the joint venture vehicle against the issuance of shares or a partnership interest, the respective assets can be transferred at book value, i.e., it is possible to avoid a taxation of hidden reserves associated with the transferred business upon formation of the joint venture.

If the parties intend to sell their shares in the joint venture vehicle in the future and if the parties are German corporations, it might be more tax beneficial to set up the joint venture as a corporation as well because, in such case, the sale of the shares in the joint venture company can be tax-exempt to a large extent.

However, it should be noted that German tax laws change frequently, so the parties should choose the legal form of the joint venture not purely based on tax considerations.

European aspects

If a German company intends to form a joint venture with a partner from the European Union, the parties now have additional possibilities to form such joint venture due to recent EU legal developments.

First, they could establish the joint venture in the form of a Societas Europaea (SE), i.e., as a European stock corporation. Although the formation of an SE is rather cumbersome, the corporate governance of a SE is more flexible than that of a German stock corporation. Furthermore, it is possible to relocate the SE, i.e., its statutory seat, from one EU country to another without having to dissolve the company. Nevertheless, the operation and administration of an SE is quite complex and costly. Therefore, an SE is only appropriate for large joint ventures or for joint ventures that are intended to be listed.

Furthermore, the European directive 2005/56 on cross-border mergers, which each EU member state had to implement into national law from 15 December 2007, introduced the possibility to form a joint venture by merging two European corporations.

In addition to these two new alternatives, which both result in the joint venture company owning assets located in different countries, there is of course the possibility to establish a holding company in one country with subsidiaries in the countries where the assets of the joint venture are located.

Corporate governance and dispute resolution

The joint venture agreement and the charter documents should provide for solutions of foreseeable disputes which might arise during the expected life of the joint venture. Because not all disputes can be anticipated, the joint venture documents also need to contain general rules on dispute resolution. This is particularly relevant if there is a risk of deadlocks between shareholders holding equal stakes in the joint venture. However, deadlocks can also arise with a majority shareholder if certain decisions need unanimous, or super-majority, shareholder approval.

An inability to timely reach necessary decisions can threaten the economic viability of a joint venture. As discussed above, German joint venture companies are mostly established as limited liability companies or as limited partnerships. Those entities mostly do not have a mandatory supervisory or advisory board (for joint ventures with at least 500 employees, a supervisory board, with employee representation, is required). It is therefore sensible to voluntarily establish a supervisory / advisory board in order to assist the executive officers or shareholders to come to necessary decisions. The legal framework for supervisory / advisory boards is flexible so that tailor-made provisions are possible. Supervisory / advisory boards should have neutral members aside from party-designees, so that the discussions do not mirror the discussion among shareholders or officers. Usually, supervisory boards have a veto-power over certain defined transactions proposed by the joint venture management. The German Supreme Court has held that supervisory / advisory boards could even themselves resolve disputes and render binding decisions as experts, provided that their composition allows neutral decisions. It is even possible to provide the supervisory / advisory board with the competence of an arbitral tribunal. Alternatively, the joint venture agreement could provide that unresolved disputes may be escalated to a committee consisting of executives of the joint venture partners.

Especially with respect to international joint ventures, dispute resolution by arbitration is preferable to resolution by state courts because proceedings are confidential and can be held in English. Furthermore, arbitral awards are often easier to enforce than court judgments. Up until very recently, there was a legal cloud in Germany over the question of whether or not shareholder resolutions can be arbitrated. In 2009, fortunately, the German Supreme Court changed its sceptical opinion and now holds that shareholder disputes can be resolved by arbitration if all shareholders: (i) approved the arbitration clause; (ii) are informed ▸▸

about the institution of arbitral proceedings; and (iii) have the right to participate in the appointment of arbitrators. Furthermore, all relevant disputes must be delegated to the same arbitral tribunal.

Exit clauses

If disputes between the joint venture partners cannot be resolved, then the partners could resolve the liquidation of the joint venture. However, liquidation will, in most cases, destroy economic value. A better way to resolve the deadlock might be having one partner exit the joint venture. Put and call options can be agreed at the outset. German law in principle also enforces so-called Russian roulette and Texan shootout clauses in their various forms. Exceptions may apply under the statutory fairness requirements if one partner unfairly takes advantage of a predicament of the other. The joint venture partners might also want to agree at the outset on co-sale rights and obligations which would foster a sale of the joint venture company to a third party. Aside from these joint venture specifics, the joint venture agreement and/or the charter documents could provide for 'ordinary' corporate termination and redemption rights. German courts enforce such clauses if there are good causes justifying the termination or redemption. Furthermore, in order to be valid, termination and redemption rights must provide for a reasonable compensation to be payable to the (involuntarily) exiting shareholder. Any clause providing for compensation below book value, or more than 50 percent below market value, could be deemed void. The validity of termination and compensation clauses largely depends on individual circumstances. ■

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