

Changing perspective

New routes and strategies as international joint ventures continue to flourish

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Joint ventures remain a key strategic option for M&A activities globally, even several years after the peak of the financial crisis that facilitated their latest revival. Though China and India remain key destinations, this continuing trend is not confined to foreign investment in BRIC countries and emerging markets. It also exists in developed economies.

While joint ventures have been around (almost) forever—for example, the German white goods group Bosch Siemens Hausgeräte GmbH (BSH) founded in 1967, and the U.S. chemical joint venture Dow Corning established in 1943 are now heavyweights in their respective markets—joint ventures have been taking new routes and deploying new strategies as they continue to flourish.

Where joint ventures are heading

The increase in international joint venture activity since 2008 can be explained in part by conventional drivers, such

as sharing of technology investments and innovation, decreasing product life cycles and funding constraints.

However, a number of specific types of joint ventures show where deal trends are heading. These include:

Bond to buy: Increasingly, buyers and sellers use joint venture structures as an interim step to full integration or divestiture. This approach allows the buyer to familiarize itself with the target and its markets without necessarily incurring the risks associated with a “full-blown” acquisition. Recently, Stahl, a Dutch private equity-owned leather services company, acquired all assets of the leather services business of its competitor Swiss Clariant, while Clariant was granted a minority stake through reinvestment in a holding company. Another example—completely different in structure—is the cooperation between German DMG Mori Seiki AG (previously Gildemeister AG) and Japanese DMG Mori Seiki Co. Ltd. This relationship kicked off in 2009 with a →

Takeaways

_ Equity joint ventures and contractual alliances remain a key strategic option for international M&A activities

_ Joint ventures are increasingly being used as an intermediate step to full integration (bond to buy)

_ Deadlock mechanisms when triggered are rarely applied but mostly used to (re)negotiate (nuclear deterrent)

Speeding up: International joint venture activity has increased since 2008. © Thinkstock/Getty Images



cooperation agreement and international cross-shareholdings, which were subsequently increased to 9.6 percent and 24.9 percent, respectively. In 2013, both companies signed a new cooperation agreement paving the way for a deeper integration.

Supply chain joint ventures: Another type of joint venture becoming increasingly common is the supply chain joint venture. It allows for forward- and backward integration of parties at different stages along the value chain. In fact, some larger industrials tend to complement their supply chain through strategic joint ventures in order to become less dependent on single source suppliers.

A frequently cited example is the joint venture between BMW Group and SGL Group established in 2009. It focuses on the exclusive supply of carbon fiber materials to the BMW Group. Another more recent example is the Singapore-headquartered joint venture established in 2013 between Clariant and Wilmar, a leading Asian agribusiness group. The joint venture operates as the global platform for the manufacture and sales of amines and selected amines derivatives and combines

Wilmar's agricultural resources and production capacities in China with a Clariant production plant in Germany. Other types of contributions include processing know-how, IP and customer relations to be used by the joint venture to expand its business on a global scale. These types of examples also illustrate flexible ways to reallocate production capacities.

Contractual alliances: An increasing number of alliances are based on a purely contractual framework without equity ownership. Such arrangements provide for more flexibility in shaping a cooperation without being bound by equity ties, which permits an easier "walk-away" in case the cooperation fails partially or even entirely.

A prominent example is the alliance between Daimler and Renault-Nissan that is underpinned by smaller reciprocal shareholdings and operates in the areas of engine and vehicle-related projects. Such types of horizontal corporation models have become popular in the automotive industry. Over the past few years, a number of automotive OEMs have started to look for alternatives to large-scale acquisitions, some of which turned out to be bitter pills. The subjects of →

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cooperation within such types of alliances are not limited to conventional licensing and development arrangements, but extend increasingly to the flexible allocation and sharing of production capacities (production networks) to achieve higher utilizations.

Complementary legal observations

While deal trends are opening new perspectives to international joint ventures, legal issues requiring consideration remain relatively stable. Still, a number of observations are noteworthy, particularly regarding the following aspects of joint ventures:

Contributions: The complexity and level of resources committed to the establishment of a joint venture largely depend on the type of contributions the joint venture partners agree to make. Such contributions often take the form of fixed and intangible assets as well as shares.

Before the contribution of certain assets (in particular, production facilities or plants) can be effected, extensive corporate reorganization measures may be required. The timing impact of such measures must not be underestimated. The respective contributions will also bring a typical M&A element to the

table as the parties will usually discuss a detailed set of representations and warranties to ensure that the joint venture will be equipped according to plan.



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The contribution of intangible assets (such as intellectual property, know-how, customer relations, etc.) adds another detail to the planning exercise. One important element of negotiating IP contributions is specifying how they will be channeled into the joint venture (via a license or a full rights transfer) and whether and to what extent such rights can be redirected to the contributor (back-licenses) outside the joint venture's field of use. Further IP issues to be considered are the potential benefits of improvements ("foreground IP") and allocation of ownership and usage rights upon termination of the joint venture.

Deadlocks: The role of radical deadlock mechanisms such as Russian roulette and Texas shoot-outs is often overstated, and they can become an unnecessary



Joint ventures remain a key strategic option for international M&A activities.

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roadblock when finalizing the deal. While the theory behind such mechanisms is somewhat enticing given that they are targeted at finding the right price for the selling shareholder (based on the old cake-cutting rule "I cut. You choose"), their role is usually confined to operating as a nuclear deterrent only. This role is demonstrated by the fact that such mechanisms are rarely put into practice and that economists increasingly regard them as ex post inefficient. More frequently, when the relationship between the parties begins to turn sour or achieving the venture's objectives becomes questionable, the parties should return to the negotiating table and discuss an appropriate unwinding concept.

The foregoing does not suggest that deadlocks should be neglected or that joint venture agreements should remain silent on them. Instead, parties should focus on determining the right balance between appropriate escalation mechanisms and termination rules as well as sufficiently define the situations constituting a "deadlock" to avoid triggering escalation mechanisms too frequently.

Choice of law: In cross-border transactions, either English or U.S. state laws remain the preferred choices. →

Dos and Don'ts

Do ...

- _ Emphasize planning, due diligence, opportunities to get to know your partner during business and legal negotiations
- _ Avoid goal incongruences, focus on a win/win situation and assess the buy and bond option at the outset
- _ Build in sufficient time to transact the parties' contributions and obtain regulatory approvals (in particular merger clearances)
- _ Consider the nature and interests of the other parties
- _ Be careful what you wish for

Don't ...

- _ Allow a joint venture to start or proceed on a weak or uncertain legal basis
- _ Underestimate the law of unintended consequences

More specifically, joint venture partners with a U.S. origin tend to opt for Delaware state law, while joint ventures with a strong European footprint choose English law and sometimes Dutch or Swiss law.

For joint ventures between Asian and European partners, it is relatively common to choose either English law or the law of an offshore jurisdiction with a similar origin, such as Singapore or Hong Kong. In China, as every joint venture contract is required by law to be approved by the government, application of Chinese law is mandatory.

Offshore structures

The general appeal of joint venture agreements being governed by Anglo-American law can be explained by the smaller number of overriding law principles that may interfere with the parties' intentions, as well as the tendency to negotiate them in greater detail.

However, mandatory application of local laws to joint venture agreements (for example in China) also makes it sometimes attractive to use offshore structures, which may also be motivated by other factors such as neutral-

ity of jurisdiction, strategic location for a hub and tax considerations. ←



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