

# VIENNA ECONOMIC TALKS

CHALLENGES OF 50-50 JOINT VENTURES IN TURKEY  
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# Controlling a JVC

Corporate Governance



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## Why 50:50 ?

- The local partner of the JVC might not allow for a majority or special rights to the foreign investor
  - No 50% + 1 share structure or special voting rights
  - Local reputational reasons
- Consolidation issue for the foreign investor, i.e. no full consolidation without
  - Special voting rights (e.g. on determination of budget)
  - Call options (e.g. “golden share”)



## Matters requiring unanimity or special majority

- Reserved Matters (matters reserved for decision by the shareholders themselves – and/or require “super-majority” vote at shareholder or board level)
  - changes in the JVC’s articles of association/by-laws;
  - new issues of share capital (including grant of share options);
  - significant changes in nature of the business of the JVC;
  - major acquisitions or disposals;
  - capital expenditure or contract commitments in excess of pre-agreed limits;
  - borrowing limits;
  - dividend policy;
  - appointment and dismissal of key management;
  - material dealings with intellectual property rights; and
  - dealings between the JVC and its shareholders.



## Reserved Matters

- Capital and budget matters as reserved matters may trigger disputes and hinder the future growth of the JVC if, in particular, the local and foreign JVC partner develop different:
  - ideas on the purpose of the JVC
  - commitment to the JVC
  - financial strength
- Importance of responsible persons within the JVC partners and equal perception of the JVC within the JVC partners' internal structures
- Quality of cooperation and communication between the responsible persons within the JVC partners as crucial factor



## Board / Management

- One board with executive and non-executive members (one-tier structure)
- Directors to be appointed by each party
  - Chairman and Vice-Chairman: appointment rights / mutual selection / rotation
  - Local reputational issues – local partner often insists on local citizen as Chairman / Vice-Chairman
  - Casting vote; super majority / veto
  - Quorum requirement
  - Method of replacement
- What matters should be dealt with at board level?
- Conflicts of interest / interested directors
- What authority should be given to individual managers?
- Signing authorities – “signature circular”



## Differences in Internal Approval Procedures

- JVC partners may differ in terms of time and reporting requirements
  - e.g.: the local partner might have stronger hierarchies with one ultimate decision making person, and
  - the foreign partner might have complicated and time consuming reporting and approval requirements
- Difficulties in the daily business of the JVC
  - Is the foreign partner “blocking” the JVC?



## Protecting a JVC

Non-Compete / Confidentiality / Default of One Party



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# Protection Provisions

- Non-Compete Provisions
  - Business scope
  - Term
  - Territory
  - Group-wide restriction
  - Exceptions (e.g. freedom to make acquisitions of businesses not significantly in competing field – possibly subject to offering the competing business to the joint venture)
  - Step-in right



## Protection Provisions

- Confidentiality Undertakings
  - Information about JVC's affairs
  - Information about the other party
  - Information about any new party in the JVC
- Protection Against Default Of One Party
  - Remedy period
  - Loss of governance rights
  - Suspension of dividend payments
  - Buy-out option – valuation
  - Compulsory sale – discount valuation
  - In practice: rarely enforced, but rather used as “motivation” to comply with contractual arrangements (other than contractual penalty)



## Problems in a JVC

When Things Go Wrong



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## Deadlock – Continuing the JVC (1/2)

- Chairman’s casting vote in deadlock situation in the board of directors
- Arbitration for dispute resolution
  - Adoption of institutional rules / provisions for “ad hoc” arbitration in case of deadlock
    - Choose a major international institution (such as ICC or ICSID) unless particular reason why not
  - Enforceability – Turkey is a party to New York Convention 1958
  - Unequivocal agreement to binding arbitration
  - Selection of a “seat” / place of arbitration
  - Appointment of Tribunal
  - Language of arbitration
  - Keep the choice of law clause
    - Turkish law as local law vs. Swiss law as “neutral” jurisdiction



## Deadlock – Continuing the JVC (2/2)

- Escalation to chairman / chief executives of JVC partners – in practice: frequently seen and used
- Outsider's / independent director's swing vote – in practice: rarely seen
- Often preferred by the JVC partners: “catholic marriage” – in practice: forces JVC partners to find mutual solution (e.g. through escalation), but problematic if one of the JVC partners does not feel committed to the JVC any longer and/or the JVC partners have different financial strengths
- Continuation of the JVC vs. exit / divorce options



## Deadlock – Divorce Measures 1/2

- Triggering events
  - One party exercising a veto on fundamental resolutions more than a specified number of occasions, or one party boycotted meetings at which such resolutions were to be considered
  - To be clearly defined – in practice: very limited triggering events specified
  - Negotiation Period / Cooling-off Period
- Voluntary / Forced Liquidation
  - JVC to be wound up, e.g. in a compulsory auction procedure
- Tailor-made mechanisms such as division of assets instead of liquidation
- Sale of JVC
- ‘Put’ or ‘Call’ options for the “compliant JVC partner”
  - Terms and conditions to be defined
  - Valuation: Reference to expert – can fault be determined? Price discount as penalty?



## Deadlock – Divorce Measures 2/2

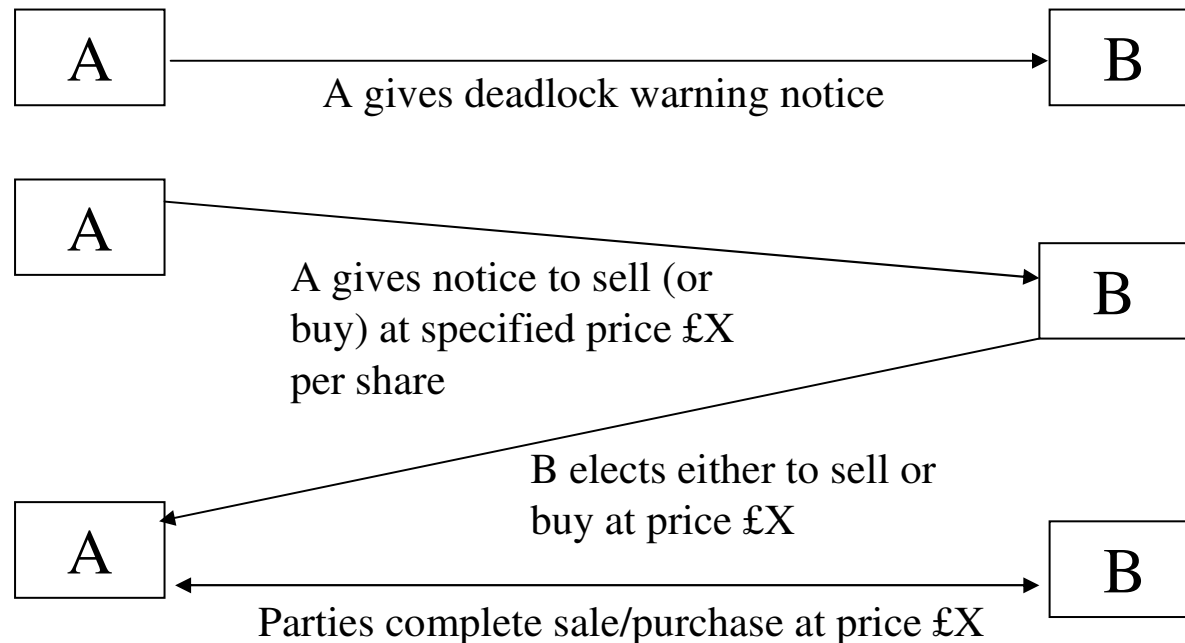
- “Shoot out” mechanisms – gambling, uncertainty and risk of abuse by partner with greater financial strength
- Advantages of shoot-outs
  - End result is that one party becomes 100% owner – there should be no restriction or circumstance which might effectively prevent one party from being a seller or buyer (such as restraints on foreign ownership in the country of origin of JVC – e.g. in Turkey media companies cannot have more than 50% of foreign capital)
  - Avoids necessity of finding third party buyer
  - In practice: rarely enforced, but mechanism forces JVC partners into negotiations
- Disadvantages
  - one party may have less financial strength and, in practice, is restricted from buying
  - where JVC depends on support dealings with one party (IP, raw materials, distribution, know-how etc.) this may cease if that party is no longer in JVC – e.g., local partner brings local market and political know-how and the foreign partner brings technical experience and know-how
  - no certainty of outcome for a party who definitely wants an exit



## Russian Roulette

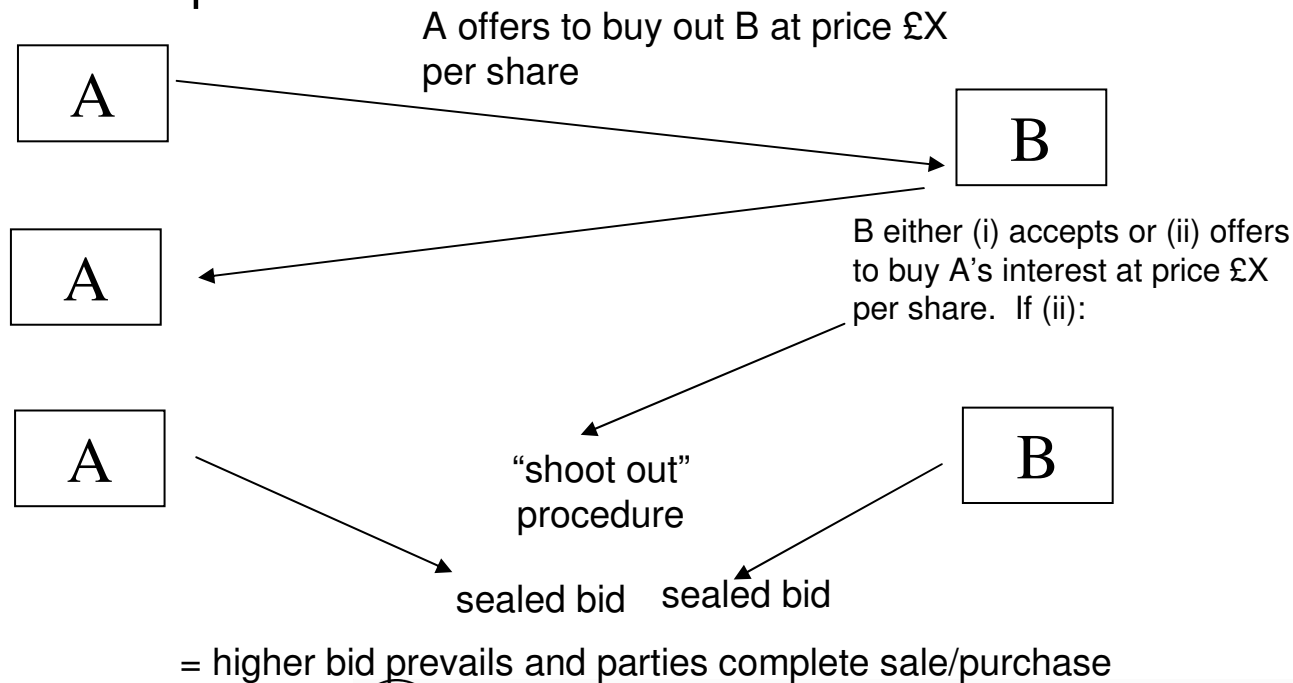
- One party initiates price and notifies the other party that it wishes to sell its shares in the JVC to the other party or buy the other party's shares
- Other party chooses to buy or sell
- Multi-step

### Example



## Texas Shoot Out

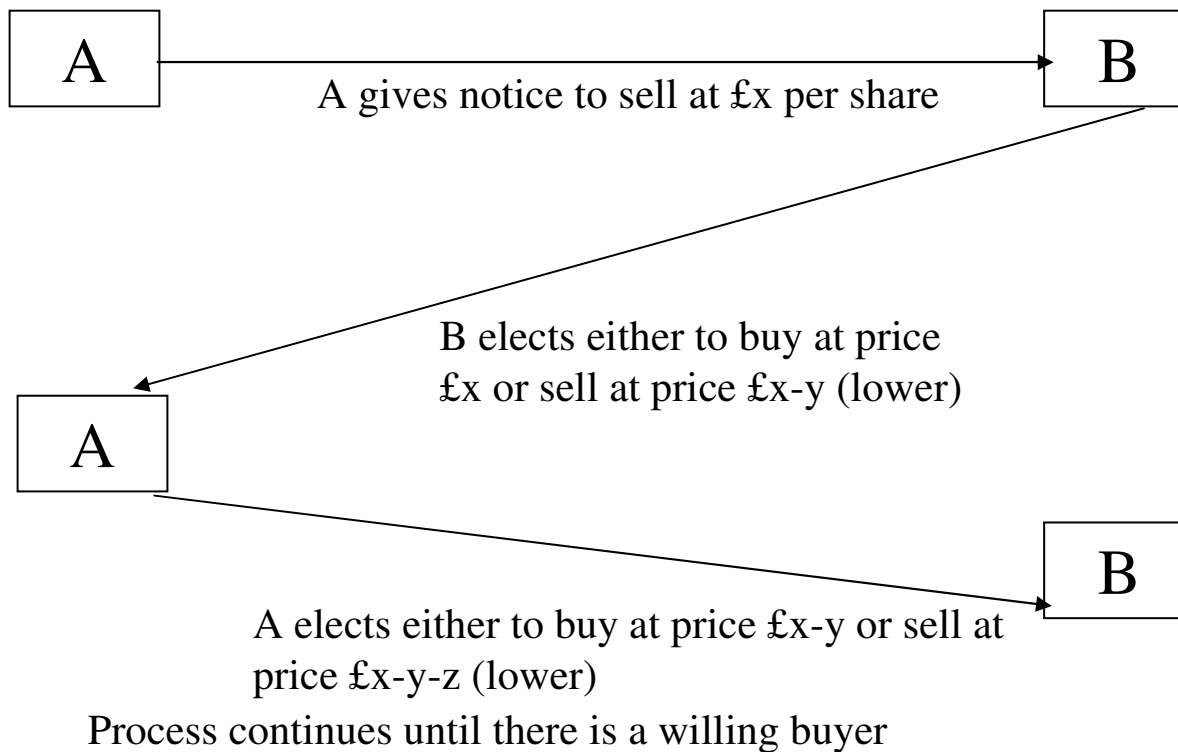
- One party notifies the other party that it is willing to purchase the other party's shares at a stated price
- The other party selects either to sell or to purchase the party's shares at a higher price
- Both parties bid - Sealed bid process
- Example



## Dutch Auction

- One party initiates sale price and states that it is willing to sell its shares in the JVC at that price
- The other party chooses to buy the shares at the stated price or sell its shares at a lower price

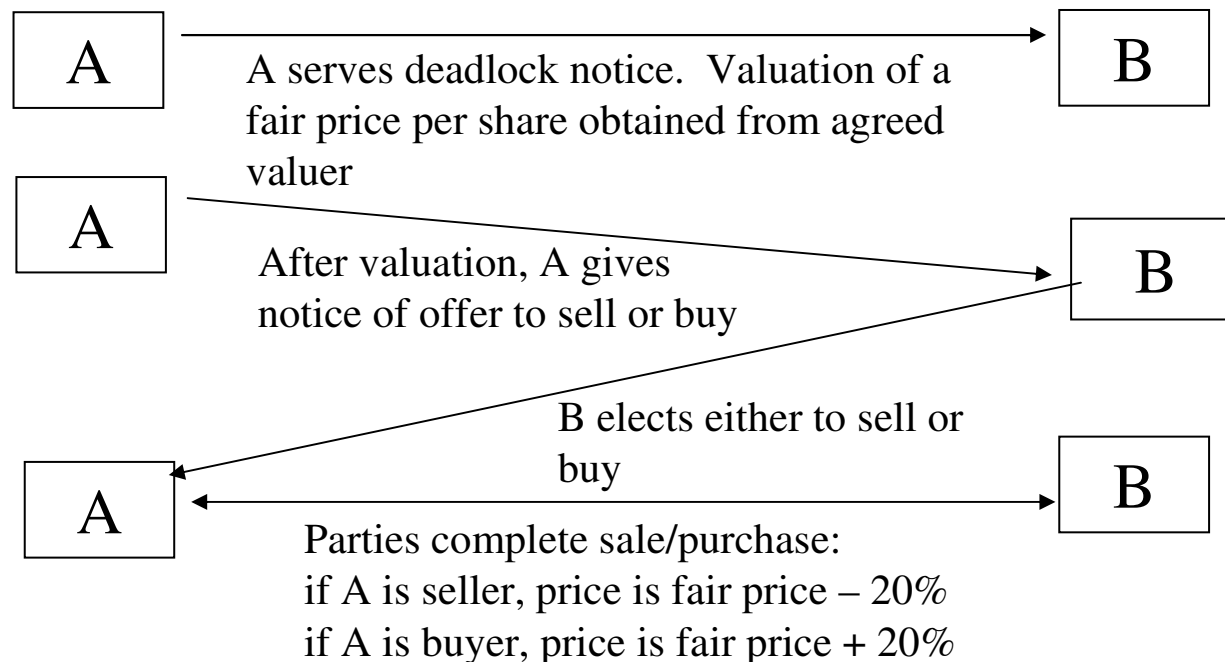
### Example



## Deterrent Approach

- One party offers to initiate a valuation procedure to determine the fair value of the shares
- The other party decides to buy the shares with a pre-agreed discounted price or sell its shares in the JVC to the other party at a pre-agreed premium

### Example



## Exit Provisions



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## Voluntary Exit

- **Can the party dispose of its share as usually legal arrangements restrict free transferability?**
  - Intra-group transfers
  - Transfers to third parties without consent
- **Pre-emption provisions**
  - Right of first offer: seller has not identified a third party purchaser but it wants to sell its shares
    - price set by seller
  - Right of first refusal: seller must identify a bona fide third party purchaser before pre-emption right is exercisable by non-seller
    - price offered by third party purchaser
- **Agreed price formula**
  - Independent valuation - 'Fair value'
  - Market value on pro rata basis
- **'Tag' along / 'Drag' along**



## Voluntary Liquidation or Winding-up of the JVC

- Allocation of assets on liquidation
- Sale of the JVC's assets and distribution of proceeds to the shareholders on a pro rata basis
- The value of the JVC on a break-up basis is likely to be less than as a going concern



## Compulsory Exit

- Trigger Events – termination for ‘cause’
  - Define clearly the ‘trigger event’ which gives rise to termination
    - Material default
    - Insolvency/liquidation
    - Change of control
    - Boycott of meetings (board level and shareholder level)
  - Decide whether termination is to occur automatically
    - grace period?
- Call option



## Conclusions



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## Factors for successful 50:50 JVs

- Importance of responsible persons within the JVC partners and equal perception of the JVC within the JVC partners' internal structures
- Quality of cooperation and communication between the responsible persons within the JVC partners as crucial factor
- [ .... ]



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