Practice Guides

SWISS M&A

Third Edition

Contributing Editors
Ueli Studer, Kelsang Tsün and Joanna Long

LEXOLOGY
Getting the Deal Through

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Practice Guide

Third edition

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Joint Ventures – Selected Aspects

Pascal Richard and Petra Hanselmann[1]

Introduction

A joint venture is an arrangement between two or more parties for pursuing a specific commercial purpose. From a business perspective, joint ventures are generally formed for the following reasons:

- to leverage resources such as capital, human resources or technology;
- to share risk, cost and resources, thereby minimising potential financial exposure; and
- to create synergies by combining complementary strengths.

While joint ventures are not confined to a specific industry, in Switzerland they have recently been seen in particular in the media, technology and financial services sectors.

A joint venture may take a vast variety of forms. This might involve transferring an existing business to the joint control of the parties or indirectly acquiring an existing business from another party, in which case organising the joint venture will involve elements of a disposition or acquisition, or both. Alternatively, an alliance may only involve licence agreements, joint marketing agreements, affiliate revenue sharing agreements or other types of agreements in which the parties agree to pursue a set of common goals.[2]

From a legal perspective, a general distinction is usually drawn between contractual joint ventures and corporate joint ventures (commonly referred to as equity joint ventures). This chapter will focus on equity joint ventures and assumes the joint venture company (JVC) is a Swiss joint stock company (AG).[3, 4]

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1 Pascal Richard and Petra Hanselmann are partners at Pestalozzi Attorneys at Law Ltd.

2 International Joint Ventures Handbook, Baker McKenzie (Editor), 2015, p1.

3 A Swiss joint stock company (Ltd/AG – *Aktiengesellschaft*) is the most common company form used for joint ventures in Switzerland; alternatively, the JVC might also be in the form of a Swiss limited liability company (LLC/GmbH).

4 For simplicity, this chapter predominantly assumes a joint venture by two parties.

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Neither the term 'joint venture' nor 'joint venture company' is specifically regulated in the Swiss Code of Obligations (CO). Rather, the law applicable to joint ventures has been developed by legal doctrine and case law. Owing to the lack of any codified legislation specifically governing joint ventures and the resulting uncertainty, it is of paramount importance for the parties to carefully address in detail their respective rights and obligations in the legal documentation governing the joint venture. Such legal documentation commonly consists of the following:

- a transaction agreement (business combination or investment agreement) and a shareholders' agreement form the basis for the joint venture between the parties. While the transaction agreement provides for the details regarding the acquisition of shares in the JVC by the parties, the shareholders' agreement deals with the various aspects following the formation of the JVC (eg, the governance principles, the financing of the JVC, the distribution policy, the information rights, the transfer of shares in the JVC, the restrictive covenants and the duration and termination of the JVC). Owing to the principle of freedom of contract in Swiss law, elements of the transaction agreement and the shareholders' agreement may also be combined in one contractual document (ie, a joint venture agreement that would thus govern the whole lifecycle of the joint venture);
- the corporate documents of the JVC, which comprise the articles of association and the organisational regulations; and
- the ancillary agreements providing the contractual framework between the JVC and the parties (eg, licensing, supply or services agreements).

Selected aspects of the transaction agreement

Corporate set-up and parties to the transaction agreement

The formation of the joint venture is typically addressed in detail in the transaction agreement. There are various ways by which a joint venture may be established. In practice, however, the two following ways seem to prevail:

- the parties form a new company and make their respective contributions to the JVC against issuance of the respective number of shares in the JVC; or
- one (or more) of the parties invests in an already existing corporate structure, in which case the relevant party makes its respective contribution to the JVC in return for shares that will be issued in the framework of a capital increase.

In such cases, the JVC will also be a party to the transaction agreement as the JVC will be obliged to issue and deliver the shares. Various issues may arise from such a contractual relationship (see 'Liability concepts').

Alternatively, shares in the existing JVC are directly acquired by one party from the other (ie, the already existing shareholder) without the issuance of new shares and without the involvement of the JVC as a party to the transaction agreement.

Determining the equity participations

One aspect that naturally needs careful consideration in a joint venture set-up is the determination of the amount of shares in the JVC a party shall receive in return for its contribution.

In an ordinary sale and purchase of shares against cash, it is customary that the parties agree either on a locked-box mechanism or on a completion accounts adjustment mechanism to determine the (final) purchase price. In the case of a locked-box mechanism, the purchase price

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is fixed at the signing of the transaction based on a reference balance sheet as at a pre-signing date. When applying a completion accounts adjustment mechanism, the initial purchase price as at signing will be subject to adjustments by reference to certain balance sheet positions as at completion of the transaction (eg, net debt, net working capital or net equity adjustment), which will eventually result in the final consideration. In a joint venture scenario, the fundamental difference from an ordinary sale and purchase transaction against cash is that the main consideration received by a party for its contribution to the JVC is not cash but shares in the JVC.

Unlike for shares in a listed company, there is typically no established market price for the shares in a JVC. Thus the value of the respective contribution made by each party to the JVC has to be established by applying the respective methodologies in order to calculate the equity participations of the parties. In this context, it is important to note that the number of shares in the JVC that a party receives depends not only on the value of its own contribution but also on the value of the contribution of the other party. Therefore, the earlier in the transaction process the equity participations of the parties can be determined and fixed, the more efficient and less complicated the transaction process as such becomes. As a consequence, a completion accounts adjustment mechanism in the transaction agreement to determine the final amount of shares to be allocated to a party will, in most cases, not be practicable, as in this case the final equity participations of the parties would only become final after completion and hence too late in the process. Thus the most viable method will often consist of applying a locked-box mechanism, determining the final equity participations at signing and making adjustments only in the case of extraordinary events. If the parties should nevertheless contemplate a completion accounts adjustment mechanism, it is recommended that such a mechanism would only provide for a cash adjustment and thus would not lead to any change in the equity participations of the parties at completion.

Contribution in kind

The formation of the joint venture typically involves new shares being issued against respective contributions. If a company at its incorporation or at a capital increase takes over assets from a shareholder by contribution in kind, Swiss law[5] provides that the articles of association of the company must disclose:

- the type of contribution;
- the valuation of such contribution;
- the name of the party that makes the contribution; and
- the amount of shares issued in consideration for the contribution in kind.

Because of the disclosure requirements, the parties must be aware that a substantial amount of information on the contribution will become publicly accessible. Further, the parties at the incorporation or the board of directors (board) of the JVC at a capital increase must verify the type, the condition of the contribution in kind as well as the adequacy of its valuation in a written report.[6] The report is subject to verification by an admitted third-party auditor (this may or may not be the

5 Article 628 paragraph 1 CO (incorporation) and article 650 paragraph 2 cipher 4 CO (capital increase).

6 Article 635 CO and 652e CO.

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JVC's statutory auditor), who has to confirm in writing that the report is complete and correct.[7] To qualify for a contribution in kind, assets must be capitalisable in accordance with the applicable accounting rules. In addition, the respective asset must be transferable and realisable, and the company must be able to freely dispose of the asset immediately after the contribution. In practice, this may raise issues in relation to contributions of intangible assets such as intellectual property, know-how or goodwill owing to the fact that it may be questionable if a respective asset fulfils the above-mentioned requirements. It is therefore important for the parties to determine their equity participations and initiate discussions with the auditor at an early stage in the transaction process. The contribution in kind may also be a mixed contribution consisting of a cash element in addition, if necessary to even out any discrepancies in the value of the contributions in kind in order to arrive at the equity participations that the parties desire to achieve. Further, the contribution in kind is based on a contribution agreement, which, depending on the nature of the asset, has to be in writing or in the form of a public deed. The contribution agreement also belongs to the documents that become publicly accessible.

In the case of a violation of the described disclosure requirements, there is a risk that the contribution in kind could be considered null and void by a court. In addition, the parties or the board of the JVC, respectively, may face civil or even criminal liability. Observance of the relevant provisions is therefore important under Swiss law.

Liability concepts

A joint venture often comprises a contribution of the parties against receipt of shares in the JVC and, as a consequence, the parties have to agree on the value of their respective contribution and the resulting equity participation in the JVC. Thus, unlike in a sale and purchase of assets against cash, there is a sell-side and a buy-side element at the same time.[8] In practice, this means that usually each party conducts a due diligence of the respective contribution of the other party. Furthermore, there will be some sort of reciprocity when it comes to protecting the parties' relevant investments (eg, each party is likely to give representations and warranties, guarantees, indemnities and covenants). In some situations, this leads to issues that are different from those in an ordinary sale and purchase transaction.

Where a party contributes assets into an already existing company held by the other party and receives shares in the relevant JVC in return, the JVC – and not the other party – will normally be liable to issue and deliver the shares in the JVC to the contributing party. Naturally, the JVC will also be liable for a breach of representations and warranties and other contractual breaches. The following issues arise with this concept:

- In the event a party brings a claim against the JVC, any payment to be made by the JVC in connection with such claim will indirectly also damage the claimant party, because of its own equity participation in the JVC. As a consequence, in order for the claimant party to be made whole for any potential claim, the JVC would need to pay more than the amount of the actual claim.[9]

---

7 Article 635a CO and 652f paragraph 1 CO.

8 The respective party contributing its asset into the JVC will 'sell' its asset to the JVC and 'buy' shares in the JVC.

9 Depending on the proportion of the parties' participation in the JVC.

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- In addition, a claim by a shareholder may also raise issues from a corporate law perspective because a payment under such a claim may result in a breach of article 680 paragraph 2 CO, which prohibits the repayment of the contributed share capital to the shareholders. Any such breach resulting from a payment will render the relevant payment null and void and may expose the board of the JVC to civil and criminal liability. Further, such a payment may also be considered a prohibited hidden distribution of profits under article 678 paragraph 2 CO and may also infringe the principle of equal treatment of shareholders under article 717 paragraph 2 CO. As a result, there is a considerable degree of uncertainty as to whether the JVC may even respond to a claim raised by a party.
- Another drawback of having the JVC as a counterparty to a claim under the transaction agreement is that the claimant party will normally also be represented by its nominated members in the JVC's board or even the management, and any such claim will necessarily have to be dealt with by these corporate bodies. It is obvious that this situation will inevitably create a conflict of interest, which would need to be resolved accordingly.

For all these reasons, it is advisable that the transaction agreement provides that claims by a party for a breach of representations and warranties, under a guarantee or for other contractual breaches, can be brought against the other party instead of the JVC. If this should not be a viable solution,[10] more refined liability concepts have to be designed. One possibility to address and potentially alleviate some of the usual concerns may consist of having warranty and indemnity insurance in place that would respond in the case of claims for a breach of representations and warranties.

Selected aspects of the shareholders' agreement

Governance and organisation

General

The main decision-making bodies of a Swiss joint stock company are the shareholders' meeting and the board. Provisions on the composition of the board and the management of the JVC, the number of board members, quorum and attendance provisions for shareholders' and board meetings, as well as potential veto rights of the parties, are key elements of any shareholders' agreement. If such contractual governance provisions are – to the extent permitted by Swiss law – in addition incorporated into the articles of association of the JVC, the mere contractual obligations among the parties become hard-wired in the sense that they are in addition enforceable from a corporate law perspective and also bind the JVC and third parties. As the articles of association become publicly accessible under Swiss law, despite the benefit of additional protection from a corporate law perspective, the parties often come to the conclusion not to mirror contractual obligations such as veto rights or a quorum provision in the articles of association, as they wish to keep the details of the internal governance of the JVC and the balance of power among the parties confidential.

10 For example, in cases of joint ventures involving private equity funds as they seek to strictly limit their liability exposure for risks that are not fully controllable.

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Shareholders' meeting

Under Swiss law, the shareholders' meeting must mandatorily resolve on certain matters, such as the approval of the financial statements, the distribution of dividends, the adoption and amendment of the articles of association or the election of the board. The parties are free to assign in the shareholders' agreement and potentially the articles of association of the JVC additional matters that are not mandatorily in the competence of the board[11] for decision by the shareholders' meeting.

According to article 703 CO, resolutions by the shareholders' meeting require the absolute majority of the votes present or represented at the meeting, subject to certain important resolutions, such as the change of the company's purpose, the liquidation of the JVC, certain forms of capital increases, certain forms of mergers, or the limitation on the transfer of shares, which require a mandatory qualified quorum of two-thirds of the votes and the absolute majority of the nominal value of the shares present or represented (article 704 CO). In the shareholders' agreement and potentially in the articles of association of the JVC, the parties may agree on higher quorum requirements for specific resolutions as provided by the CO. Depending on the equity participations of the parties in the JVC, such specific agreed quorum requirements may result in a veto right of one or several parties. In practice, specific quorum requirements or veto rights are often introduced for the amendment of the articles of association, the election and removal of board members, capital increases and decreases, the liquidation of the JVC, approval of the financial statements and dividend distributions.

Swiss law does not provide for strong protection rights of minority shareholders. Besides the qualified quorum for certain resolutions mentioned above, minority shareholders holding 10 per cent of the total share capital have the right to request a shareholders' meeting or the adding of an item to the agenda for a specific shareholders' meeting. The latter right also applies to shareholders representing shares with a nominal value of 1 million Swiss francs. As a consequence, additional minority protection measures need to be stipulated in the shareholders' agreement and mirrored in the articles of association (to the extent desirable) and the organisational regulations of the JVC.

Board of directors

According to article 716a CO, the board has certain non-transferable and inalienable duties, such as the ultimate management of the company and the issuance of the necessary directives, the structuring of the accounting system, of the financial controls and of the financial planning or the appointment of the management. Such matters must mandatorily remain in the decision competence of the board and may not be delegated, neither to the management nor to the shareholders' meeting.

According to article 713 CO, resolutions by the board require the majority of the votes cast. The parties can agree on higher quorum or presence requirements. Such quorum or presence requirements may result in a veto right of one or several parties with respect to selected matters such as the approval of the budget and business plan, acquisitions and disposals of a business, investments and financings above a certain threshold, approval on the transfer of restricted shares, appointment and removal of managers and amendments of the organisational regulations.

11 See 'Board of directors'.

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As a default provision, the CO provides that in the case of a tie, the chairman of the board shall have the casting vote. Therefore, if the casting vote of the chairman shall be excluded, the parties should explicitly agree accordingly in the shareholders' agreement and also stipulate this in the articles of association and the organisational regulations. For non-listed companies, the chairman of the board is by default appointed by the board from among its members. However, it is possible to delegate the right to appoint the chairman of the board to the shareholders' meeting. With regard to the composition of the board, Swiss law does not provide for any nationality requirements on the board. The entire board may consist of foreign nationals. However, at least one authorised signatory (ie, either a board member or another person authorised to act on behalf of the JVC) with single signature right or two authorised signatories with joint signature right need to be domiciled in Switzerland.

The members of the board are not parties to the shareholders' agreement. As a consequence, the shareholders' agreement does not directly bind the members of the board. In practice, the issue is addressed by a provision in the shareholders' agreement according to which the parties undertake to procure that the board members appointed by them will observe the provisions of the shareholders' agreement. This may, however, result in a delicate situation for the board members. On the one side, according to article 717 CO, board members have to act in the best interest of the JVC. On the other side, they should act in accordance with the instructions of the respective party for which they sit on the board of the JVC and by which they are mandated. As a consequence, from their own liability perspective, in the case of a conflict between the interests of the JVC and the interests of a party, the board members should act in the interests of the JVC and against the provisions of the shareholders' agreement.

Organisational regulations

Under Swiss law, the board may only delegate the management of the JVC if the articles of association of the JVC explicitly allow the board to do so by way of the adoption of organisational regulations (whereas, in any event, the board may not delegate its non-transferable and inalienable duties, as mentioned above). The organisational regulations typically govern, among other things:

- the rights and duties of the board including the details for the convocation of meetings and the above-mentioned quorum requirements;
- the delegation of the day-to-day business by the board to the management;
- the rights and duties of the management and specific members of the management, such as the CEO and CFO; and
- the signature authority of the board members and members of the management.

The provisions of the shareholders' agreement and the articles of association should, to the extent applicable, be mirrored in the organisational regulations. Contrary to the articles of association, the organisational regulations do not become publicly accessible. To avoid any discrepancies between the shareholders' agreement, the articles of association and the organisational regulations, the shareholders' agreement should contain a provision stating that the provision of the shareholders' agreement shall prevail among the parties.

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Deadlock devices

In 50:50 joint ventures, but also in joint ventures in which a party has been granted veto rights to block certain material decisions,[12] there is always the risk that the parties may reach a deadlock situation on a particular issue. There are many potential solutions on how to address a deadlock. In practice, frequently used instruments to overcome a deadlock are:

- the granting of the tiebreaking vote to the chairman of the board;
- the granting of the tiebreaking vote to an independent, non-executive board member;
- the referral of a deadlock matter to an independent third party for solution; or
- the referral of the deadlock matter to the upper-level management of the parties in combination with put-and-call options or liquidation rights if the escalation process should ultimately fail.

In our experience, such internal escalation process to the upper-management level, or even up to the CEO or the chairman of the board of the parties, has proven to be an effective solution in practice. As the management of the parties typically wants to avoid an escalation to the top-level management, compromises acceptable to both parties are often found at an early stage in such a set-up. Even if the escalation goes to top management, the potential threat of the call-and-put option process, which could kick in, for example, in the form of 'Russian roulette'[13] provisions or blind bids,[14] often helps the parties to find a common understanding. However, it has to be mentioned that such provisions are only meaningful in practice if the parties have similar financial resources available and not both parties are required for the continuance of the JVC. In such a constellation, the winding-down or liquidation of the JVC might be the only option left. As the composition and underlying interests in a joint venture can be very diverse, potential deadlock instruments must be analysed and determined for each joint venture individually. To avoid a deadlock situation at all, it is first of all important that the parties carefully govern their rights, obligations and responsibilities in the shareholders' agreement and ancillary documents.

Transfer restrictions

Shareholder agreements usually contain restrictions on the transfer and encumbrance of the shares in the JVC, such as lock-up periods, rights of first refusals, pre-emption rights, call option rights and sometimes also tag-along and drag-along rights. Under Swiss law, such provisions can, according to majority doctrine, no longer be included in the articles of association of the JVC. As a consequence, if a party violates the share transfer restrictions, the other parties typically can only claim contractual damages against the breaching party under the shareholders' agreement. To reduce the risk that a party breaches the transfer restrictions, it is possible and market-standard to provide in the articles of association of the JVC that in the case of registered shares, such shares may only be validly transferred with the consent of the board. The board may object against a share transfer for important reasons explicitly stipulated in the articles of

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12 This will typically be the case for any reserved matters at board or shareholder level.

13 One party makes an offer and the other party has to buy the shares of the other party at the offered price or sell its shares for the offered price.

14 Both parties simultaneously make an offer to each other to buy the shares of the other party and the higher offer is successful.

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association of the JVC or if it offers to acquire the shares from the selling party for the company's own account, for the account of other shareholders or for the account of third parties at their real value at the time the transfer request was made. According to article 685b paragraph 2 CO, provisions governing the composition of the shareholder group that are designed to safeguard the pursuit of the company's objects or its economic independence are deemed to constitute important reasons. As the consent of the board to share transfers is typically subject to a special majority quorum agreed by the parties in the shareholders' agreement, such transfer restrictions contained in the articles of association of the JVC prevent shares being sold by one party without the knowledge of the other parties or at least without the knowledge of the board. To safeguard compliance with the transfer restrictions, the parties can in addition agree to issue physical share certificates and to deposit such share certificates with an independent escrow agent. Although frequently seen in practice, it should be noted that depositing the shares with an escrow agent is not to be deemed an entirely watertight solution as there may still be ways that enable an non-permitted share transfer in specific cases.

Duration and termination

Under Swiss law, contracts cannot be entered into for an eternal period as the personal and economic freedom of a contracting party may not be restricted in an excessive way. Eternal agreements are not fully void but a judge may reduce the term of such eternal agreement to an acceptable limited term. As joint ventures are not specifically governed under Swiss law, there is a certain risk that the shareholders' agreement could be qualified as a simple partnership, with the consequence that the provisions of article 545 et seq CO and in particular article 546 CO would be applicable. Article 546 CO provides that if the parties have not agreed on a specific term, the partnership agreement can be terminated within six months (ie, a notice period that is inadequate for most joint ventures). As a consequence, it is in any event recommended to specify the term of a shareholders' agreement governed by Swiss law.

Generally, a term of up to 20–25 years is, under certain circumstances, still considered as non-excessive according to doctrine and case law. In practice, a shareholders' agreement in a joint venture context often has a term of 10–15 years and provides for an extension of an additional fixed term of 1–5 years if not terminated by a party after the initial or any extended period. It is also common that the parties agree on additional termination possibilities, such as, for example, in the case of:

- a change of control over one of the parties;
- the opening of insolvency or similar proceedings over a party;
- a material violation by a party of its obligations under the shareholders' agreement, the transaction agreement or any of the ancillary agreements; or
- deadlock situations that could not be resolved by the parties through other means provided in the shareholders' agreement.

These events will typically also trigger a call option right for the party that is not affected by the aforementioned events.

Ancillary agreements

In addition to the transaction agreement and the shareholders' agreement, a joint venture set-up usually requires the execution of a number of further agreements, such as, for example,

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licensing, supply or services agreements. Such ancillary agreements are typically entered into by the JVC and the parties or any of their affiliates. There are regularly certain interdependencies among the ancillary agreements on the one side and the transaction agreement and the shareholders' agreement on the other side that need to be carefully addressed and aligned when drafting the various agreements. The effectiveness of an ancillary agreement may, for example, depend on the fulfilment of certain conditions by the other party and, once the shareholders' agreement is terminated, the parties do typically also wish to end or at least amend the terms and conditions of the ancillary agreements, so that the term and termination of the various agreements need to be aligned in order to avoid any unexpected consequences.

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Appendix 1

About the Authors

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Pascal Richard is a partner at Pestalozzi Attorneys at Law Ltd. Pascal graduated from the University of Berne in 2003 and was admitted to the Zurich bar in 2006. He holds an LLM from the College of Law of England and Wales and is qualified as a solicitor of the Senior Courts of England and Wales. Previously, Pascal worked as legal counsel in the legal department of a Swiss defence and technology group of companies and as an associate and partner respectively in business law firms in London and Zurich. Pascal advises listed and non-listed clients on domestic and international M&A, joint venture and carve-out transactions in particular in the financial services industry, as well as general corporate and commercial matters.

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Petra Hanselmann is a partner at Pestalozzi Attorneys at Law Ltd. Petra graduated from the University of Zurich Law School in 2002 and, after her bar admission in Switzerland in 2005, she obtained an LLM in corporate law from New York University in 2007. From 2007 to 2022 she worked with other major law firms in Zurich and New York. Petra's professional practice is focused on advising domestic and international clients in the areas of mergers and acquisitions, private equity and corporate reorganisations. She has broad experience in particular in cross-border M&A, international joint ventures, carve-out transactions and post-merger integrations with a focus on the industrial, technology and finance sectors.

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