

InfoPAKSM

Joint Ventures International Transaction Guide: Memorandum of Understanding

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Joint Ventures International Transaction Guide: Memorandum of Understanding

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This InfoPAKSM provides a memorandum of understanding relating to a two-party proposed 50:50 international joint venture, where both parties intend to contribute existing businesses to a newly formed joint venture company. This document has been adapted from Practical Law's UK version to provide a plain English, jurisdiction-neutral starting point for local counsel to adapt for use in cross-border transactions. The document has integrated drafting notes discussing the key legal, negotiating and drafting issues.

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I. General Document Notes

This memorandum of understanding is drafted for use in a two party 50:50 joint venture where both parties intend to contribute existing businesses in return for shares in a joint venture company (JVC). The standard document has been adapted from Practical Law's UK version to provide a plain English, jurisdiction-neutral starting point for local counsel to adapt for use in cross border transactions.

The memorandum of understanding is relatively detailed. The advantage of this approach is that key issues are addressed at an early stage before money is spent on valuation, due diligence, further negotiations and drafting. The memorandum can also help to avoid misunderstandings and provide a useful map of steps to be taken on the way to signing the formal agreement. However, there are also potential disadvantages:

- The parties may spend considerable time negotiating a detailed memorandum of understanding and then repeat the exercise (and duplicate costs) when negotiating the shareholders' agreement and other joint venture documents.
- In some civil code jurisdictions, a detailed memorandum of understanding may be construed by the courts as a binding pre-agreement (possibly even if, as here, it is expressed to be non-binding).
- Even though expressed not to be legally binding in most respects, a memorandum of understanding creates a moral commitment. It may be difficult to change key terms once "agreed" in the memorandum, which could significantly affect a party's bargaining power at a later stage.
- The parties should also be aware of the duty of good faith which applies to contractual negotiations in most civil code jurisdictions. The memorandum evidences the serious intentions of the parties and the duty of good faith will be construed accordingly. Any departure from its terms could be construed as a breach of the duty giving rise to a claim for damages.
- For commentary on memoranda of understanding and the duty of good faith, see [*Practice note, Preliminary agreements: international acquisitions*](#).

II. Memorandum of Understanding

A. Background

- Note: There is no standard form for a memorandum of understanding (also known as heads of terms). They can vary from a simple letter to a carefully drafted document prepared by advisers.

Two important issues are covered in the Background section:

- The memorandum is not intended to be legally binding except as specifically stated in relevant clauses. However, as stated above, moral obligations are created and the statement may not be sufficient to prevent courts in some civil code jurisdictions from giving legal effect to the memorandum.
- The memorandum is specifically made subject to a confidentiality agreement already entered into by the parties.

It is possible that other parties, besides the two joint venturers, should sign the memorandum, for example any guarantors of the parties' obligations under the final documentation.

(A) [FULL COMPANY NAME] (X) and [FULL COMPANY NAME] (Y) are proposing to form a new company for the purposes of [DESCRIBE JOINT VENTURE] (**Joint Venture**). This memorandum of understanding sets out the proposed terms of the Joint Venture and timetable for implementation. It is not intended to be legally binding except as specifically set out below.

(B) This memorandum of understanding is confidential to the parties and their advisers, and is subject to the confidentiality agreement dated [DATE] already entered into between X and Y, which continues in full force and effect. This paragraph is legally binding.

B. Agreed Terms

I. Business of the JVC

- Note: Business of the JVC

It is helpful to set out the intended scope of the joint venture to clarify the intentions of the parties. If detailed, it could possibly be set out in a separate schedule.

The parties wish to enter into the Joint Venture to [REASONS FOR JOINT VENTURE AND INTENDED SCOPE (PRODUCTS AND TERRITORY)].

2. Structure

■ Note: Structure

The memorandum envisages that the joint venture will be conducted through a corporate vehicle. A variety of considerations will influence the choice of structure and its location (commercial, legal and tax) (see Practice note, Structures: international joint ventures). The words in square brackets are intended to give some flexibility to the parties in the choice of structure. If the structure is changed purely for tax reasons there is a danger that relevant tax authorities could challenge it on the basis that the sole purpose of the new structure is to avoid tax.

2.1 It is proposed that the Joint Venture will be conducted through a [DESCRIBE CORPORATE VEHICLE] incorporated in [COUNTRY], to be formed by the parties on or before closing (JVC) [but the parties may agree a different structure if it becomes necessary or desirable for commercial or other reasons].

2.2 The name of the JVC will be [NAME] or such other name as the parties may agree.

2.3 The headquarters of the JVC will be based in [LOCATION OF HEADQUARTERS].

2.4 Each party will own half of the share capital of the JVC and will have equal shareholder voting rights.

3. Contributions to the Joint Venture and Finance

■ Note: Contributions to the joint venture and finance

It is envisaged that both parties will contribute existing businesses to the JVC in consideration for the issue of shares. The businesses will be valued after signing of the memorandum of understanding by an independent valuer and, if one business is valued at less than the other, the owner of the lesser valued business will make a cash payment equal to the difference in value. This raises a number of issues:

- It may not be necessary to commission an independent valuation. Ideally the parties should agree a valuation based on their own due diligence.
- Both parties should consider the potential tax costs of contributions to the joint venture. Will they each bear their own tax costs? Should some adjustment be made in respect of valuation to take account of the tax costs borne by the parties on contributions? Tax costs on formation can be deal breakers and should be considered at the outset. A party that raises tax costs at a later stage may be accused of seeking to re-negotiate the terms of the deal.
- The instructions to the valuer need to be carefully drafted, ideally with input from the valuer and each party's accountants. Valuation is subjective and can be technically complex. It is also likely to be the most

important and emotive issue in the joint venture negotiations. Agree, so far as possible, the approach to be taken to the valuation in advance; this will help to avoid surprises and disagreement once the valuation has started. The instructions should ideally include, for example, the agreed approach to the calculation of profit (such as depreciation rates, valuation of stock-in-trade, bad debt write off and so on) and valuation (notably, the basis of valuation (for example, discounted cash flow, net asset value and so on)). Particularly in a cross-border context, significant differences may arise in reported profits depending on the applicable accounting rules and how they have been interpreted.

- In many countries, if a company issues shares in return for assets, a formal valuation process is required by company law. Consider how this will dovetail with the parties' own valuation and the impact on the timetable.
- All or part of the consideration for the transfer of businesses to the JVC could be left outstanding as loans from the parties to the JVC. This may be preferable from a tax perspective (as interest on loans is generally tax deductible, unlike dividends). However, beware of thin capitalisation rules operated by the tax authorities in many countries (see [Practice note, Tax: international joint ventures](#)).

3.1 As consideration for the issue of shares in the JVC to X at closing, X shall transfer to the JVC the [DESCRIBE BUSINESS TO BE CONTRIBUTED BY X] (**X Business**) and make any cash payment required by paragraph 3.4.

3.2 As consideration for the issue of shares in the JVC to Y at closing, Y shall transfer to the JVC the [DESCRIBE BUSINESS TO BE CONTRIBUTED BY Y] (**Y Business**) and make any cash payment required by paragraph 3.4.

■ Note: Equalisation payments

The businesses to be contributed will be valued after signing of the memorandum of understanding by an independent valuer. If one business is valued at less than the other, the owner of the lesser-valued business will make a cash payment equal to the difference in value.

Rather than an equalisation payment, the parties could agree that one party foregoes dividends until the shortfall in value is made up, or that certain assets or liabilities are excluded from the business contributions. Alternatively, they could take unequal shareholdings based on the relative valuations although this would fundamentally change the nature of the joint venture and drafting of the documents. (If one party is to have control, they may agree a dilution of their controlling interest to reflect a control premium.)

3.3 Upon signing this memorandum of understanding, the parties intend to appoint [NAME OF VALUER] (**Valuer**) to conduct an independent valuation of the X Business and

the Y Business on the basis of agreed instructions, a copy of which is annexed to this memorandum of understanding.

3.4 If different values are attributed by the Valuer to the X Business and the Y Business, the party that contributes the lesser valued business shall make a cash payment equal to the difference in value in part consideration for the issue of shares in the JVC at closing [or the parties shall agree an alternative arrangement for bridging any difference to maintain the 50:50 equity relationship within the JVC].

- Note: Equalisation payments

See Drafting note, Equalisation payments above.

3.5 [The definitive agreements for the Joint Venture will provide that, if either party gives inaccurate or misleading information to the Valuer in connection with the valuation referred to in paragraph 3.3, or withholds information that could have a material impact on the valuation, it will compensate the other party on an indemnity basis for any difference between the original valuation and a revised valuation as determined by the Valuer (as if made at the same time as the original valuation but based on correct information).]

- Note: Indemnity for provision of inaccurate information to the valuer

This paragraph provides that the definitive agreements will make provision for compensation on an indemnity basis if either party gives inaccurate or misleading information to the valuer for the purposes of the valuation or withholds information that could have a material impact on the valuation. This may be contrary to the spirit of mutual trust and confidence that are the foundation of any joint venture but is a prudent measure given the commercial importance of the valuation.

The provisions could be included in the shareholders' agreement or the acquisition agreements relating to the two businesses. Careful drafting will be required in the definitive agreements. Consider to whom the indemnity should be given (the JVC or the other party) and the relationship with other warranties and indemnities given in respect of the transferred businesses.

3.6 Each party will conduct investigations into the business to be contributed by the other to the JVC that will include: [LIST SPECIFIC REPORTS AND INVESTIGATIONS REQUIRED].

3.7 Each party will allow the other party, its advisers and the Valuer full access to such records, key employees, advisers and operations of the X Business and the Y Business as are reasonably required for the purposes of the valuation of the X Business and the Y Business and each party's investigations.

3.8 The parties and the JVC will execute acquisition agreements relating to the sale of the X Business and the Y Business to the JVC which will incorporate warranties and indemnities and other terms negotiated between the parties.

- Note: Acquisition agreements

The memorandum envisages that the parties will sign acquisition agreements relating to the sale of their businesses to the JVC, with warranties and indemnities. Consider who will have the benefit of the warranties and indemnities. Normally it will be the JVC. However, they could instead be given directly to the other shareholder although any payments would be likely to be taxed in the hands of that shareholder.

3.9 The parties envisage that the Joint Venture shall be self-financing. They do not envisage having to provide any further finance to the Joint Venture. However, if further finance is required [the parties intend to contribute equally **OR** it shall be provided, so far as practicable, from external funding sources].

4. Conditions and Approvals

- Note: Conditions and approvals

Ideally this paragraph should cover all the main conditions that may have to be satisfied before the joint venture proceeds.

The proposed Joint Venture will be conditional on:

(a) both parties accepting the valuation referred to in paragraph 3.3 and otherwise being satisfied with the results of their investigations into the business to be contributed by the other party to the Joint Venture;

- Note: Agreement of valuation

- The venture is conditional on both parties agreeing the valuation. If one party invokes this condition and the other is able and willing to proceed, consider providing that the first party should compensate the other for wasted costs (see paragraph 14). This is a pre-signing condition and could therefore be put in a different category to the other conditions which are in effect pre-closing conditions.

(b) [the shareholders of both parties approving the Joint Venture;]

(c) any third party, regulatory or tax consents required for the Joint Venture being received in terms satisfactory to both parties;

(d) [a satisfactory outcome of the consultation with the employees of the X Business and the Y Business;]

(e) there being no material adverse change in the business, operations, assets, position (financial, trading or otherwise), profits [or prospects] of the X Business or the Y Business between the signing of this memorandum of understanding and closing;

(f) no legislation or regulation being proposed or passed that would prohibit or materially restrict the implementation of the definitive agreements or the participation in the Joint Venture of either party; and

(g) each party producing a legal opinion, in a form satisfactory to the other, confirming that it has the capacity to enter into the Joint Venture.

- Note: Accounts: paragraph 5 to Termination and liquidation: paragraph 11

These provisions summarise related clauses in the joint venture shareholders' agreement. For full commentary, see the integrated drafting notes in [*Standard document, Shareholders' agreement: international joint ventures*](#).

5. Accounts

5.1 The financial year end of the JVC will be [YEAR END].

5.2 The accounts of the JVC will be prepared in accordance with [RELEVANT ACCOUNTING STANDARDS] and the first auditors of the JVC will be [NAME OF AUDITORS].

5.3 The management of the JVC will prepare an annual business plan for approval by the parties as shareholders and monthly management accounts, which will be sent to the parties as shareholders (together with such other financial and operational information as they may reasonably require from time to time). The first business plan will be prepared by the parties and adopted by the JVC at closing.

6. Management and Employees

6.1 Each party will appoint an equal number of directors to the board of the JVC, who will have equal voting rights. No board resolution will be passed without at least one director appointed by each party voting in favour of it. The post of chairman will be held by an appointee of each party in rotation in alternate years. The chairman will not have a casting vote.

6.2 The following board appointments will be made on formation of the JVC:

- (a) [NAME] will be Chairman;
- (b) [NAME] will be Chief Executive Officer;
- (c) [NAME] will be Chief Financial Officer;
- (d) [NAME] will be [OTHER KEY POSITION OR DIRECTOR];
- (e) [NAME] will be [OTHER KEY POSITION OR DIRECTOR]; and

(f) [NAME] will be [OTHER KEY POSITION OR DIRECTOR].

6.3 The board of directors will be responsible for the day to day management of the JVC, but the following issues will be reserved for agreement between the parties as shareholders:

- (a) altering in any respect any constitutional documents of the JVC or the rights attaching to any of the shares in the JVC;
- (b) permitting the registration of any person as a member of the JVC other than X and Y [in respect of their initial investment] [and any of their permitted transferees];
- (c) altering the name of the JVC;
- (d) adopting or amending the business plan for each financial year; and
- (e) [OTHER RESERVED MATTERS].

6.4 [DETAILS OF EMPLOYEES TO BE TRANSFERRED TO THE JVC AND HOW IT IS INTENDED THAT REDUNDANCY COSTS (IF ANY) WILL BE BORNE BY THE PARTIES.]

7. Dividend Policy

The parties intend that the JVC will [distribute by way of dividend at least [NUMBER]% of profits available for distribution in each financial year, unless they agree otherwise **OR** not distribute a dividend until any and all loans to the JVC from the parties have been repaid in full].

8. Restrictions on Parties

The parties will give undertakings not to compete with the business of the JVC and not to solicit its customers or employees.

9. Deadlock

If there is a disagreement between the directors or the parties as shareholders that cannot be resolved at board or shareholder level, the matter will be referred to the Chairmen of the parties and, failing agreement, a termination process as outlined in the definitive agreements for the Joint Venture will ensue.

10. Transfer of Shares

Neither party will be able to transfer shares to a third party without first offering to sell them to the other party at the price of the proposed sale to the third party. However, such pre-emption will not apply to intra-group transfers of the whole of a party's shareholding.

11. Termination and Liquidation

11.1 If either party materially breaches the agreement governing the Joint Venture, becomes insolvent or is subject to a change of control, the other party shall be entitled to purchase its shares in the JVC at a price to be determined by an independent expert.

11.2 If the JVC is wound up, the parties will endeavour to ensure that, before dissolution, assets contributed by each party will, so far as possible, be transferred back to that party.

12. Language

- Note: Language

Note that some documents may be required by law to be in a certain language. For example, the JVC's by-laws will have to be in the language of the country of incorporation. Some countries may require all joint venture agreements with local participants to be in a local language and governed by local law.

The negotiations will be conducted in [LANGUAGE] and all legal agreements relating to the Joint Venture will be prepared in [LANGUAGE].

13. Exclusivity

- Note: Exclusivity

This provision, sometimes known as a lock-out, seeks to ensure that neither party negotiates with a third party for a defined period of time. The period of exclusivity should not exceed the minimum amount of time that the joint venturers may reasonably need to conclude the transaction.

For a detailed commentary on exclusivity agreements, see [Practice note, Preliminary agreements: international acquisitions](#).

In many jurisdictions, this provision cannot be expressed as a positive obligation to negotiate. It is becoming common practice in some countries to provide for a specific amount of compensation for breach of an exclusivity agreement. Usually this amount has to be a reasonable pre-estimate of loss and may be reduced by the courts if it is not.

13.1 This paragraph 13 is legally binding.

13.2 In consideration of the mutual undertakings each party gives to the other in this paragraph 13, each party warrants that it is not currently carrying out any of the

activities listed in this paragraph and undertakes that for a period of [NUMBER OF WEEKS/MONTHS] from the date of signing this memorandum of understanding, it shall not:

(a) commence or continue negotiations for the sale or any other type of disposal of all or a significant part of the X Business or the Y Business (as the case may be) to a third party; or

(b) commence or continue negotiations about a potential joint venture with a third party, the business of which may overlap with the proposed business of the Joint Venture; or

(c) disclose any information (including, without limitation, information about the X Business or the Y Business) to a third party for the purpose of negotiations relating to a sale or other disposal or joint venture described in paragraph 13.2(a) or paragraph 13.2(b); or

(d) seek, encourage or respond to any approach that might lead to negotiations relating to a sale or other disposal or joint venture described in paragraph 13.2(a) or paragraph 13.2(b).

13.3 Each party shall ensure that its employees, agents and advisers comply with the undertakings in this paragraph 13 as if they were the relevant party.

13.4 Each party acknowledges that the other will incur significant costs, fees and expenses by relying on this paragraph and that, if it breaches this paragraph, it shall (without prejudice to any other remedies the other party may have) indemnify and keep indemnified the other party for all costs, fees and expenses incurred in connection with the valuation referred to in paragraph 3.3 and investigations, negotiations and preparation of documents relating to the proposed Joint Venture.

14. Costs

■ Note: Costs

The paragraph provides that the parties will share the costs of the valuer and the costs of preparing certain documents. Instruct advisers to bill separately for the preparation of these documents and other advice given to either party.

Each party can end negotiations without giving any reason for so doing. This is an important provision as, without it, a party that withdraws from negotiations for no reason could, in some jurisdictions, be liable for breaching the duty of good faith.

The memorandum could provide for a break fee if either party withdraws from the transaction for specific reasons (such as failure to obtain shareholder approval or because it does not accept the valuation). Break fees are common in

transactions in a number of jurisdictions. If the company agreeing to pay the break fee is a quoted company, then depending on the specific rules of the jurisdiction that apply, the agreement to pay a break fee may be conditional on shareholder approval being obtained.

14.1 This paragraph 14 is legally binding and is subject to paragraph 13.

14.2 The fees of the Valuer appointed under paragraph 3.3 shall be borne equally by the parties.

14.3 The fees of [ADVISORS] relating to the preparation of [DOCUMENTS] shall be borne equally by the parties.

14.4 Subject to paragraph 14.2 and paragraph 14.3, each party shall be responsible for its own costs (including, without limitation, costs relating to the investigations of the businesses to be contributed by the other party to the Joint Venture referred to in paragraph 3.6).

14.5 Each party may end negotiations in relation to the proposed Joint Venture without having to give any reason for doing so or incurring any liability to the other party.

15. Governing Law and Jurisdiction

- Note: Governing law and jurisdiction

Mandatory provisions of local law may apply notwithstanding the choice of law clause. For example, the duty of good faith is a mandatory law in many civil code jurisdictions that cannot be excluded by contract. Similarly, the by-laws of the JVC and, possibly, other documents, will be subject to the law of the country in which the JVC is incorporated.

15.1 This paragraph 15 is legally binding.

15.2 This memorandum of understanding, and all negotiations and any legal agreements prepared in connection with the Joint Venture, and any dispute or claim arising out of or in connection with them or their subject matter or formation, shall be governed by, and construed in accordance with, the law of [RELEVANT JURISDICTION].

15.3 Each party irrevocably agrees that the courts of [RELEVANT JURISDICTION] shall have exclusive jurisdiction to settle any dispute or claim arising out of or in connection with this memorandum of understanding, the negotiations relating to the proposed Joint Venture and any legal agreements prepared in connection with the Joint Venture or their subject matter or formation.

C. The Schedule

I. Proposed Timetable

- Note: Proposed timetable

The timetable envisages that the parties start their own due diligence and that draft documents are prepared while the independent valuation takes place. It may be prudent to await the outcome of the independent valuation before any other costs are incurred, as this is likely to be the most heavily contested issue.

Action	Responsibility	Timing/deadline
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Instruct Valuer		
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Start due diligence		
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Prepare first draft of shareholders' agreement and by-laws of the JVC		
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Prepare first drafts of [OTHER DOCUMENTS]		
---	--	--

Establish third party consents and approvals		
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Valuation complete		
--------------------	--	--

Agree business plan		
---------------------	--	--

Signing		
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Closing		
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ANNEX

Instructions to Valuer

Each party hereby confirms its agreement to the terms contained in this memorandum of understanding.

Signed by [DIRECTOR OR OFFICER] for and on behalf of [PARTY X]

Date:

Signed by [DIRECTOR OR OFFICER] for and on behalf of [PARTY Y]

Date: