"Deadlock Provisions in Equity Joint Venture Agreements"

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I hereby declare that I have read and understood the regulations governing the submission of dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

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Signed by candidate

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A. Introduction

There are numerous reasons in today's business world, with its continuously increasing globalisation, for entering into business cooperations in which two or more parties agree to achieve fixed objectives in a joint project for a certain period of time – a "***Joint Venture***". In most cases the parties are legally and economically independent companies and the reasons and objectives of each company to enter into the joint venture are different, ranging from pooling resources, getting access to know-how or even to new markets, reducing costs and risks to solving management or succession problems.

During the cooperation, the different objectives of each party, policy changes, market developments or other circumstances might lead to disagreements over the strategy or the management of the joint venture and if this occurs, it possibly transpires that there is a conflict which cannot be dissolved by the parties, potentially leading to the end of the cooperation – a "***Deadlock***". In such a situation the contractual provisions of the agreement entered into by and between the parties regulating and setting out the rights and obligations of each party, in particular the provisions relating to a deadlock – the "***Deadlock Provisions***", become essential.

After a short description of the various types of joint ventures in Section B and the structure of an equity joint venture in Section C, this dissertation focuses on the analysis of typical deadlock provisions of equity joint venture agreements which are discussed in detail in Section D by means of examples of clauses. Apart from provisions preserving the joint cooperation, the main focus is on provisions which force the exit of, at least, one party to the joint venture. The dissertation concludes with a short summary in Section E.

The objective of this dissertation is to provide a comprehensive overview of the usual drafting possibilities of deadlock provisions which can be included in a joint venture agreement, differentiating between preservation mechanisms and exit mechanisms. Due to the diversity of deadlock provisions and their possible combinations, it does not purport to be complete or to provide a detailed analysis of all relevant issues.

B. Equity or Contractual Joint Venture?

In general, there are two different ways a joint venture can be structured. On the one hand, the parties can enter into an agreement which regulates the whole cooperation, known as "***Contractual Joint Venture***". On the other hand, the parties can establish a legally independent company which conducts the joint business, known as "***Equity Joint Venture***". Even if the majority of business cooperations are structured in the form of equity joint ventures, which structure is appropriate depends on each individual case.

As part of a contractual structure, the partners retain their decision-making autonomy within the boundaries set out in the joint venture agreement, whereas in a joint company the decision-making bodies will be obliged to act primarily for the sake of the company and the partners can only use their influence on the company as shareholders (including the exercise of their voting rights in shareholders' meetings) to pursue their individual interests. Compared to an equity joint venture, the establishment and administration of a contractual joint venture is usually less expensive, the assets required to run the joint project can be provided by each partner separately without obtaining joint property and there is no insolvency risk of a joint company, enabling the partners to terminate the cooperation without attracting the public attention through statutory insolvency proceedings.[1]

Contractual joint ventures are, generally speaking, mostly suitable for individual and short-term projects, such as: research & development agreements, strategic alliance agreements, cooperation agreements, master framework agreements, licensing agreements, supply agreements, distribution agreements, etc.

This being said, a contractual joint venture generally works best if (i) each party's contribution is limited, specific and easily defined, (ii) the parties want to be able to terminate the joint venture without difficulties, and (iii) optimal tax planning does not require the use of one or more joint entities.

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[1] *Fett/Spiering*, chap. 2, paras. 7, 25 *et seqq*.

In contrast hereto, equity joint ventures are mostly suitable for (i) long-term projects, (ii) projects for which a joint financing is required, and (iii) where an independent market presence should be established.

In accordance herewith, the advantages of an established joint venture company are that: it can create a new brand in the market (corporate identity) and is able to act independently. The participation of the parties has a clear structure which corresponds to the stake held in the joint company. Finally and often most important, by choosing a legal form for the joint venture company, the parties can limit their liability.

C. Structure of Equity Joint Ventures

I. General Structure

The structure of equity joint ventures is distinguished by the fact that a legally independent joint venture company runs the business. The joint venture agreement and, at least to the extent required by law, the company's articles of association regulate the relationship between the joint venture partners among each other and toward the company, setting out their specific rights and obligations.[2] Since it is in the interest of the partners to have joint control over the company, they usually include relevant provisions in the joint venture agreement, *inter alia*, provisions regulating (i) corporate governance, (ii) financing, (iii) reporting obligations, (iv) changes in the ownership structure, (v) dealing with deadlock situations, etc.[3]

The precise structure of the company, including its legal form, the agreed terms in the joint venture agreement and the company's articles of association, depends on many different factors (such as the place, size and business purpose of the joint venture, number of shareholders and the legal form of the company etc.) and, therefore, it is a result of the underlying circumstances and negotiations between the joint venture partners.

However, once the final legal structure has been agreed upon, the company can be set up in several ways: (i) it can be newly established by the parties (through (de-)merger); (ii) the parties can purchase an existing shelf company; or (iii) the parties can receive

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2 *Fett/Spiering*, chap. 2, para. 14.
3 *Fett/Spiering*, chap. 2, para. 15.

their stakes in a company owned by one of the parties through sale, capital increase, or merger.

II. Specific Structure, incl. Example of Clauses

The following standard sections of a draft joint venture agreement (hereinafter, the "**Draft**") describe the scenario and set out the specific structure of the joint ventures which are discussed in this dissertation and for which the examples of clauses are drafted. Once a term has been defined in a clause, it is used in the following clauses of the Draft in the same sense.

According to the Draft, a 50/50 equity joint venture shall be established between two parties, a German company and a South African company:

EXAMPLE CLAUSE: PARTIES' SECTION

JOINT VENTURE AGREEMENT

BETWEEN

(1) **X-GmbH**, a German limited liability company (*Gesellschaft mit beschränkter Haftung – GmbH*) organized under the laws of Germany, registered with the commercial register (*Handelsregister*) of the local court (*Amtsgericht*) of [*city*] under registration number HRB [*registration number*] and having its seat in [*seat*], Germany

- "**X-GmbH**" -

(2) **Y-(Pty) Ltd**, a South African private limited liability company organized under the laws of South Africa, registered with the companies register of the Companies and Intellectual Property Commission (CIPC) under registration number [*registration number*] and having its seat in [*seat*], South Africa

- "**Y-(Pty) Ltd**" -

X-GmbH and Y-(Pty) Ltd are also individually referred to as a "**Partner**" and collectively as the "**Partners**".

By entering into the Draft, which shall be governed by German law, the South African company, Y-(Pty) Ltd, shall undertake to purchase and receive 50% of a German limited liability company held by X-GmbH as its sole shareholder:

EXAMPLE CLAUSE: PREAMBLE

PREAMBLE

(A) X-GmbH is the sole shareholder of Joint Venture GmbH, a German limited liability company (*Gesellschaft mit beschränkter Haftung – GmbH*) organized under the laws of Germany, registered with the commercial register (*Handelsregister*) of the local court (*Amtsgericht*) of [*city*] under registration number HRB [*registration number*] and having its seat in [*seat*], Germany (the "**Company**").

(B) On the date hereof, X-GmbH (as seller) and Y-(Pty) Ltd (as purchaser) will enter into a "*Share Purchase and Transfer Agreement regarding the Sale and Transfer of Shares in Joint Venture GmbH*" (the "**SPA**") regarding the sale and transfer of shares in the Company representing 50% (fifty per cent) of the registered issued share capital (the "**Transaction**").

(C) The Partners contemplate to regulate the operation, corporate governance and management of the Company and the relationship of X-GmbH and Y-(Pty) Ltd as shareholders of the Company in this joint venture agreement (the "**Agreement**").

The corporate governance of the joint venture company shall consist of the shareholders' meeting and the managing directors as mandatory corporate bodies pursuant to German law and an additional supervisory board which is not obligatory in a German limited liability company (*Gesellschaft mit beschränkter Haftung – GmbH*). The managing directors as well as the members of the supervisory board shall be nominated equally by the shareholders, which shall then be appointed by the shareholders' meeting, accordingly:

EXAMPLE CLAUSE: CORPORATE BODIES

6 CORPORATE GOVERNANCE

6.1 CORPORATE BODIES OF THE COMPANY

The Company shall have three (3) company bodies, namely:

(a) The shareholders' meeting (*Gesellschafterversammlung*) (the "**Shareholders' Meeting**");

(b) the supervisory board (*Aufsichtsrat*) (the "**Supervisory Board**"); and

(c) the managing directors (*Geschäftsführung*) (the "**Managing Directors**").

6.2 SHAREHOLDERS' MEETING

6.2.1 General Competencies. The Shareholders' Meeting of the Company shall have the powers as ascribed to it by applicable statutory law and the articles of association of the Company. The Shareholders' Meeting shall appoint (*bestellen*) and remove (*abberufen*) the Managing Directors (*Geschäftsführer*) as well as the members of the Supervisory Board (*Aufsichtsrat*).

6.2.2 Actions requiring Shareholders' Meeting Approval. [*intentionally left blank*]

6.2.3 Voting. Shareholders' resolutions shall be adopted with a simple majority of votes cast unless otherwise set forth in this Agreement, the articles of association of the Company or mandatory statutory law. Each EUR 1.00 (in words: Euro one) in the nominal value of a share gives one (1) vote. Abstention from voting shall be considered as a dissenting vote.

6.2.4 Quorum. [*intentionally left blank*]

6.3 SUPERVISORY BOARD

6.3.1 Composition. The Company shall have a Supervisory Board comprising of six (6) members (each a "**Supervisory Board Member**"). The Partners shall use their voting rights as shareholders of the Company, to the extent legally permissible, to ensure that the positions of such Supervisory Board Members shall be appointed (*bestellt*) by the Shareholders' Meeting accordingly as follows:

(a) Three (3) Supervisory Board Members to be appointed (*bestellt*) without undue delay (*unverzüglich*) upon proposal by X-GmbH; and

(b) three (3) Supervisory Board Members to be appointed (*bestellt*) without undue delay (*unverzüglich*) upon proposal by Y-(Pty) Ltd.

6.3.2 Removal. Each Partner shall be entitled to request at any time the removal and replacement of the respective appointed representative as Supervisory Board Member in accordance with Section 6.3.1(a) or Section 6.3.1(b) (as applicable) and the other Partner shall upon such request vote in favour of the removal of such person as Supervisory Board Member.

6.3.3 Actions requiring Supervisory Board's Approval. [*intentionally left blank*]

6.3.4 Voting. [*intentionally left blank*]

6.3.5 Quorum. [*intentionally left blank*]

6.4 MANAGING DIRECTORS

6.4.1 Appointment. The Company shall have two (2) Managing Directors (*Geschäftsführer*) and the Partners shall use their voting rights as shareholders of the Company, to the extent legally permissible, to ensure that the positions of such Managing Directors shall be appointed (*bestellt*) by the Shareholders' Meeting accordingly as follows:

(a) One (1) Managing Director to be appointed (*bestellt*) without undue delay (*unverzüglich*) upon proposal by X-GmbH; and

(b) one (1) Managing Director to be appointed (*bestellt*) without undue delay (*unverzüglich*) upon proposal by Y-(Pty) Ltd.

6.4.2 Power of Representation. [*intentionally left blank*]

6.4.3 Removal. Each Partner shall be entitled to request at any time the removal and replacement of the respective appointed representative as Managing Director in accordance with Section 6.4.1(a) or Section 6.4.1(b) (as applicable) and the other Partner shall upon such request vote in favour of the removal of such person as Managing Director.

6.4.4	Voting. [*intentionally left blank*]
6.4.5	Quorum. [*intentionally left blank*]

This structure of an equity joint venture as described in the Draft taken as a basis, certain deadlock provisions regularly found in equity joint venture agreements are explained and analysed in the following Section D. For this purpose, typical clauses are provided as examples represented in such a way as if such clauses are taken from a single agreement. The structure of such clauses follows the pattern of the standard clauses as set forth above, and the clauses are numbered equally in case that they are replaceable, *e.g.*, "*6.3 DEADLOCK RESOLUTION (Russian Roulette Clause)*" or "*6.3 DEADLOCK RESOLUTION (Texan Shoot-Out Clause)*".

D. Deadlock Provisions in Equity Joint Venture Agreements

I. Definition and Scenarios

In the context of a joint venture agreement, the underlying reasons for the occurrence a deadlock between the business partners are countless, in particular disagreements over the strategy or the management of the joint venture, the extent of shareholder rights, or the dissolution of the joint venture company.

As already stated in the Introduction (Section A), a deadlock usually occurs when the parties of a cooperation have a disagreement which cannot be dissolved by them cooperatively. The dissention can hereby appear on each level of the company, namely, it can occur either between the joint venture partners in the shareholders' meeting or between the joint venture partners' representatives on the management level (board of directors / managing directors) or on the level of an additional body (supervisory board / advisory board).

A deadlock can arise (i) in a 50/50 joint venture where the parties cannot agree; (ii) in a joint venture where a minority shareholder exercises a given veto right; (iii) in a multi-party joint venture where one or more parties vote against a resolution requiring an unanimous decision; or (iv) one of the parties refuses to attend meetings (whether

at shareholder or board level), so that required resolutions cannot be passed and/or the joint venture cannot be conducted.[4]

The most common scenario is scenario (i), *i.e.*, the corporate bodies of the joint venture company are equally represented by representatives of both parties without having a decision-making mechanism in place, such as a tie-breaking vote, and a dissention between the members of the respective body occurs.[5]

The most serious scenario is scenario (iv), *i.e.*, a party of the joint venture company is not willing to meet the other party/ies in order to discuss the matters in question and, therefore, does not attend the respective board or shareholders' meetings, so that necessary decisions cannot be made. This may happen in a joint venture where the quorum of the relevant corporate body can only be achieved if and when (i) one or more (minority) shareholder(s) or its/their representative(s) must be present at a meeting; or (ii) a specific percentage of the company's share capital must be represented.

II. General Statements

During the term of any business cooperation it is normal and highly likely that there will be differences of opinion regarding the strategy or the management of the joint venture company. In a joint business cooperation such differences of opinion can either result in the development of new ideas and concepts through controversial discussions between the joint venture partners or, if the partners are not able to dissolve the situation, a deadlock situation can occur.

Besides any statutory rights pursuant to the applicable law[6] to resolve such a deadlock situation, the joint venture partners can decide to handle any deadlock situation *ad hoc* without having any specific deadlock provisions in place, as discussed in Section D.III, or they can agree upon certain deadlock mechanisms.

In order to include deadlock mechanisms, the joint venture partner have to define the term "deadlock" as the trigger event. The arising questions related hereto are discussed in Section D.IV.

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4 Schulte/Schwindt/Kuhn/*Kuhn*, § 8 para. 8; American Bar Association, p. 1189; *Hewitt*, p. 241.
5 Schulte/Schwindt/Kuhn/*Kuhn*, § 8 para. 8.
6 If appropriate or necessary for any explanations, reference is made to German law.

Some of these mechanisms seek to prevent or resolve the deadlock by implementation of an additional decision-taking process or by facilitating an agreement between the joint venture partners, thus preserving the joint cooperation. These preservation mechanisms are discussed in Section D.V. Other mechanisms are more fundamental and require the exit of, at least, one of the disputing parties from the joint venture, possibly bringing the joint cooperation to an end. These exit mechanisms are discussed in Section D.VI.

III. Ad hoc Solution

Apart from the enormous variety of deadlock preservation and exit mechanisms which can be agreed upon between the partners of a joint venture (reference is made to Sections D.V and D.VI), the partners can abstain from any such regulations relying on their ability to find a proper solution "*ad hoc*" if and when the disagreement between them arises, taking into account that, in most cases, the economic pressure, sooner or later, will lead to a *de facto* constraint to come to an appropriate consensual agreement.[7] Even if there is the chance that the partners can agree upon a solution, there is a high risk that such a mutual consent cannot be found (within a short period of time) and that the deadlock situation will have a significant negative economic effect on the

[7] *Fett/Spiering*, p. 593.

joint business.[8] In other words, the flexibility of this approach is counteracted by a certain lack of clarity about the required steps to be taken in order to resolve a deadlock situation (*e.g.*, (lengthy) negotiations between the partners involving further representatives, obtaining of expert opinions, etc.).

The outcome of this procedure can of course result in an agreement of the joint venture partners to resolve the disagreement to continue with the joint venture, but also it can result in a decision to end the cooperation.

Even if it is not required to include a specific clause in the joint venture agreement, the partners can, for instance, agree on the following clause in order to express their willingness to seek a solution in the event of a deadlock between them. Such provision should be drafted as an obligation so that the partners consider themselves to be under an active commitment to find a solution, even though such an obligation would be hard to enforce under German law.

EXAMPLE CLAUSE: AD HOC SOLUTION

6 DEADLOCK

6.1 DEADLOCK SITUATION AND SOLUTION

In the event of a deadlock, breakdown or other circumstances in which a Partner wishes to terminate or substantially change the structure of the Company (irrespective of the nature of the matter in issue which has occurred between them or their respective representatives on any management, supervisory, advisory or other boards of the Company), the Partners undertake to use [best | reasonable] efforts, including, to the extent legally permissible, their influence as shareholders on the respective board of the Company, to resolve such situation on an amicable basis, in good faith, and to achieve an outcome which is in the best interests of the Company considering all the circumstances and which does not negatively impact the interests of one of the Partners more than the other.

IV. Deadlock

Once the joint venture partners have, in general, agreed that mechanisms to prevent, resolve or overcome a deadlock should be included in the joint venture agreement, the circumstances have to be determined in which such deadlock mechanisms should be triggered. To define the term “deadlock” as the trigger event the following questions

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[8] *Fett/Spiering*, p. 593.

should be answered: (i) On which level of the company should a deadlock arise? (as outlined under Section D.IV.1) ; (ii) Which matters should trigger the agreed mechanisms? (as outlined under Section D.IV.2); (iii) Should a "boycott of meetings" qualify as a deadlock? (as outlined under Section D.IV.3); and (iv) Should a deadlock trigger the deadlock resolution mechanisms directly or after a respective (written) notice from one joint venture partner to the other(s)? (as outlined under Section D.IV.4).

1. Company Body Level

Given the usual company structure, for instance, of a German limited liability company comprising of the shareholders' meeting, usually responsible for the company's long-term goals and business objectives, and the management, responsible for the daily business, there are at least two levels in an equity joint venture where a disagreement during the decision-making process can arise. In the event that there is a compulsory or voluntary third company body established and depending on its function (*e.g.*, supervisory board or advisory board), there is a further level where a dispute possibly can arise.

However, it is the decision of the joint venture partners what type of dispute on which level of the company will qualify as a deadlock situation triggering the agreed mechanisms. Basically, all variations and combinations are conceivable: from the situation where each matter in dispute on each level directly triggers the agreed exit mechanism to the situation where only a qualified matter in dispute between the shareholders after certain unsuccessful preservation mechanisms (*e.g.*, tiered escalation procedure or mediation) triggers the agreed exit mechanism.

It is normally not the intention of the joint venture partners that every deadlock situation regardless of its commercial relevance, in particular a deadlock within the company's management in the daily operational business, directly triggers time-consuming and often costly deadlock procedures which may result in the liquidation of the joint venture company.[9] One common approach to reduce such risk is that disputes among members of the management, at first, are escalated directly, or indirectly through an

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[9] *Fett/Spiering*, p. 596.

advisory/supervisory board, to the shareholders' meeting before further preservation or exit mechanisms shall apply – a ***Tiered Procedure***.

Please refer to the following clause providing such a tiered procedure:

EXAMPLE CLAUSE: TIERED PROCEDURE

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.1.1 Best Endeavours. The Partners shall use their [best | reasonable] efforts to resolve any controversy, disagreement or dispute between them on an amicable basis, in good faith, and to achieve an outcome which is in the best interests of the Company considering all the circumstances and which does not negatively impact the interests of one of the Partners more than the other. The Partners shall use the corporate governance mechanisms in this Agreement to resolve disputes. Failing that, they shall resolve any disputes in accordance with this Section 6.

6.1.2 Management Disagreement. If the Managing Directors are unable to resolve a disagreement between them on a material matter within a fourteen (14) calendar days' period after the disputed matter first being considered, each Managing Director has the right to escalate the matter to the Supervisory Board for urgent resolution.

6.1.3 Management Escalation Mechanism. If the disputed matter is proposed at a duly convened meeting of the Supervisory Board of the Company and the Supervisory Board refuses to deal with the matter or is unable to resolve the matter (regardless of the reason, in particular due to negative vote(s), abstention from voting, invalid vote or required representatives being not present), the matter shall be escalated to the Shareholders' Meeting for urgent resolution.

6.1.4 Deadlock. [*intentionally left blank*]

2. Matter in Dispute

Another way to reduce the risk that any kind of dispute can trigger deadlock resolution mechanisms and, therefore, to enhance the confidence of the partners in the long-term existence of the joint cooperation is the determination or designation of certain matters in dispute. Only if the joint venture partners cannot reach an agreement about such a specific determined or designated matter, deadlock mechanisms can be activated, limiting the scope of the agreed deadlock mechanisms on every company level.

The following three different structures can therefore be distinguished: the relevant company body cannot agree on: (i) any matter, a ***Deadlock Matter*** (as outlined under lit. a) below); (ii) any matter determined as a deadlock matter by the partners on the establishment of the joint venture, a ***Reserved Deadlock Matter*** (as outlined under lit.

b) below); or (iii) any matter designated as a deadlock matter by any one of the partners at the time the relevant matter has arisen, a ***Designated Deadlock Matter*** (as outlined under lit.c) below).

a) Deadlock Matters

Firstly, the joint venture partners can agree upon that there shall be no limitation with respect to the type of matter in dispute which can result in a deadlock. Following this approach, any disagreement about any type of matter (i) triggers directly the agreed deadlock resolution mechanisms, *i.e.*, preservation mechanisms and/or exit mechanisms; or (ii) in case that a further notice is required, gives a joint venture partner the right to trigger such mechanisms (reference is made to Section D.IV.4).

Please refer to the following clause providing no limitation with regard to the type of matter in dispute or the company body level on which the dispute has arisen:

EXAMPLE CLAUSE: ALL MATTERS

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

For the purpose of this clause, "**Deadlock**" shall be deemed to have occurred if:

(a) any matter relating to the Company has been raised at and/or considered by the Managing Directors, the Supervisory Board or the Shareholders' Meeting of the Company and no resolution has been passed on [at least [two] successive occasions by][10] such meeting as a result of an equality of votes cast for and against any resolution proposed in respect of that matter; or

(b) [a quorum is not present at [two] successive duly convened meetings of the Managing Directors, the Supervisory Board or the shareholders by reason of the absence from that meeting of the same Partner, or in the case of a meeting of the Supervisory Board or the Managing Directors, a person nominated as a Supervisory Board Member or Managing Director by that same Partner, respectively.][11]

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[10] ***Note to Draft***: Either the first meeting where no resolution has been passed can be determined as a "Deadlock" directly, or subsequent unsusccessful meetings may be required.

[11] ***Note to Draft***: Such a deadlock event is not necessary if the joint venture agreement provides that a subsequent meeting of the relevant company body is qualified as a meeting with a quorum regardless of the presence of the "blocking" shareholder or its representative, respectively, as explained under Section D.V.3 below.

[For the avoidance of doubt, there is no Deadlock if a meeting, or adjourned meeting, is inquorate because the person who proposed the resolution does not attend.][12]

Having no restriction of possible deadlock matters in place bears the risk that matters without great commercial relevance can cause deadlock procedures and, in the worst case, can bring the cooperation to an end. The restriction of potential deadlock matters can, therefore, limit the risk that a joint venture partner use the deadlock mechanisms, in particular exit mechanisms, to take advantage of the other partner, which, for example, has not the financial resources to buy out the other partner.

In order to cover all matters in principle but to minimize the risk that any matter irrespective of its commercial relevance will trigger the deadlock resolution mechanisms, the joint venture partners might narrow down the scope of the deadlock resolution mechanisms by (i) determination of a threshold; and/or (ii) using certain qualifying conditions regarding the matter in dispute (*e.g.*, "*substantial, structural and beyond the day-to-day matters*").[13] Only in cases where the relevant company body cannot come to an agreement about a matter with a value above the prescribed threshold or a substantial matter, the respective deadlock mechanisms will be triggered automatically or can be triggered by a partner by (written) notice depending on the terms agreed.[14] Matters with a value below such threshold and without the required relevance will be considered as "not adopted" by the respective company body without triggering any mechanism.[15]

It should be noted that a qualification as described under (ii) obviously bears the risk that disagreements between the joint venture partners arise whether or not the matter in dispute meets the agreed qualifying conditions.

Please refer to the following clause providing a threshold and qualification language:

EXAMPLE CLAUSE: ALL MATTERS WITH QUALIFICATIONS[16]

6 DEADLOCK AND DEADLOCK RESOLUTION

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[12] Please refer to fn. 11.
[13] *Elfring*, NZG 2012, 895 (896 *et seq*.).
[14] *Elfring*, NZG 2012, 895 (897).
[15] *Elfring*, NZG 2012, 895 (897).
[16] Wording based on: *Hewitt*, p. 759.

6.1 DEADLOCK

6.1.1 Deadlock Matters. The Partners agree that for the purposes of this Agreement an event shall only be qualified as a deadlock if the matter affecting the relationship of the Partners as shareholders of the Company (i) exceeds an economic threshold in the amount of EUR 500,000 (in words: Euro five hundred thousand); or (ii) is substantial, structural and beyond the day-to-day matters, *e.g.*, a dispute regarding the provision of any required funding of the Company ("**Deadlock Matters**" and separately, a "**Deadlock Matter**").

6.1.2 Deadlock. For the purpose of this clause, "**Deadlock**" shall be deemed to have occurred if:

(a) any Deadlock Matter has been raised at and/or considered by the Managing Directors, the Supervisory Board or the Shareholders' Meeting of the Company and no resolution has been passed on [at least [two] successive occasions by] [17] such meeting as a result of an equality of votes cast for and against any resolution proposed in respect of that matter; or

(b) [a quorum is not present at two successive duly convened meetings of the Managing Directors, the Supervisory Board or the shareholders [(being, in each case, a meeting at which a Deadlock Matter was on the agenda to be decided)] by reason of the absence from that meeting of the same shareholder, or in the case of a meeting of the Supervisory Board or the Managing Directors, a person nominated as a Supervisory Board Member or Managing Director by that same Partner, respectively].[18]

[For the avoidance of doubt, there is no Deadlock if a meeting, or adjourned meeting, is inquorate because the person who proposed the resolution does not attend.][19]

b) Reserved Deadlock Matters

Secondly, the joint venture partners can agree upon that a deadlock shall only be triggered if the matter in dispute was determined as a "deadlock matter" by the partners upon the establishment of the joint venture. Representing the most important issues for cooperating parties, such a catalogue of predetermined deadlock matters regularly contains, *inter alia*, the following matters: (i) adoption of the business plan and/or annual budget and any amendment thereof, (ii) approval of the annual statutory financial statements, (iii) approval of the appropriation of profits, (iv) appointment or removal of the company's auditor, (v) appointment or removal of the company's managing directors,

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[17] Please refer to fn. 10.
[18] Please refer to fn. 11.
[19] Please refer to fn. 11.

(vi) resolutions regarding any capital measures, (vii) mergers, demergers and modification of the company and/or of the company's subsidiaries and (viii) winding-up procedures concerning the company and/or the company's subsidiaries.

If the joint venture partners have agreed on a catalogue of measures pursuant to which the management of the joint venture company requires the (prior) approval of an advisory/supervisory board or the shareholders' meeting, in most cases it can be referred to such catalogues of measures, since it is typically the will of the partners that the deadlock resolution procedures should be triggered if a dissention about one of these essential matters arises.[20]

The provision of such a catalogue of measures minimizes the scope of the deadlock resolution mechanisms ensuring that such mechanisms will, or can, only be triggered if the joint venture partners are not able to come to an agreement about material questions.

Please refer to the following clause providing such a catalogue of matters which triggers the deadlock resolution mechanisms:

EXAMPLE CLAUSE: RESERVED DEADLOCK MATTERS

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.1.1 Deadlock Matters. The Partners agree that for the purposes of this Agreement each of the following shall be a "**Deadlock Matter**" and, collectively, the "**Deadlock Matters**":

(a) adoption of any business plan and/or annual budget or any amendment thereof by the date falling three (3) months after the start of any business year;

(b) approval of the annual statutory financial statements of the Company (*Feststellung des Jahresabschlusses*);

(c) approval of the appropriation of profits (*Gewinnverwendung*) of the Company; or

(d) [any of the Reserved Shareholder Matters [or Reserved Supervisory Board Matters]].[21]

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[20] *Fleischer/Schneider*, DB 2012, 961 (961); *Göthel*, BB 2014, 1475 (1476).

[21] ***Note to Draft***: Depending on the specific circumstances, further matters have to be added/categorized as Deadlock Matters, directly or indirectly as Reserved Shareholder Matters or Reserved Supervisory Board Matters.

6.1.2 Deadlock. [reference is made to the aforementioned "Example Clause: All Matters with qualifications" in the Section D.IV.2.a) above]

c) Designated Deadlock Matters

Thirdly, and finally, the joint venture partners can agree upon that either of them should have the right to designate a matter as a deadlock matter at the time the relevant matter has arisen.

Please refer to the following clause providing the right of either joint venture partner to designate a deadlock matter:

EXAMPLE CLAUSE: DESIGNATED DEADLOCK MATTERS[22]

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.1.1 Deadlock Matters. The Partners agree that for the purposes of this Agreement an event shall only be qualified as a deadlock if the matter affecting the relationship of the Partners as shareholders of the Company has been previously designated by either of the Partners to be of material importance for the Company by [written] notice (a "**Deadlock Matter**") setting out in as much detail as possible the nature of the matter, that Partner's position in relation to it and any proposals for its resolution.

6.1.2 Deadlock. [reference is made to the aforementioned "Example Clause: All Matters with qualifications" in the Section D.IV.2.a) above]

Like the provision of a catalogue of measures, the requirement to designate a potential deadlock matter before the partners or the partners' representatives speak about the relevant matter reduces the risk that non-material questions trigger, or can be used to trigger, the deadlock resolution mechanisms. After the designation of a matter as a deadlock matter, the partners are aware that this matter in question is of material importance for the partner who designated it and that the deadlock resolution mechanisms will, or can, be triggered if they are not able to find a solution in the respective resolution process. While increasing the pressure on the following discussions, the designation gives also the partners the chance to consider the other partner's concerns beforehand, so that they can prepare themselves in order to negotiate more efficiently and to find a solution agreeable for all partners.

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[22] Wording based on: *Hewitt*, p. 759.

3. Boycott of Meetings

As already stated in Section D.I above, the most serious deadlock scenario is a situation in which joint venture partners boycott board or shareholders' meetings. To prevent such a serious situation in which any decision-making is blocked, the partners can agree upon that (i) a boycott of board or shareholders' meetings will be qualified as a deadlock and thus the agreed deadlock procedures will, or can, be triggered; or (ii) a subsequent duly convened board or shareholders' meeting after a previous meeting without reaching the required quorum will have a quorum regardless of the presence of a specific shareholder, its representative or a specific percentage of the company's share capital.

In most cases, the latter option that a subsequent meeting with the same agenda will definitively have a quorum seems preferable. Such a provision ensures that the blocking partner is forced to return to the "negotiation table", *i.e.*, to attend the subsequent meeting, since otherwise the present partner would have the power to resolve any matter of the agenda without the participation of the absent partner in the subsequent board or shareholders' meeting.

Furthermore, in case of a majority joint venture, such a regulation can ensure, on the one hand, that each resolution will be resolved with the minority shareholder's knowledge, while, on the other hand, the majority shareholder can be assured that, at least, a subsequent meeting will have a quorum even if the minority shareholder does not attend.

However, because of the potential risk that there could be a potential scenario in which the other partner has the power to adopt any kind of resolution alone, many joint venture partners are not willing to agree upon such a provision.[23] This argument can be addressed, but cannot be excluded completely, by the formal requirement that the invitation to the subsequent meeting must indicate this important fact.

The first option mentioned above, *i.e.*, the qualification of any non-attendance as a deadlock in terms of the joint venture agreement triggering the agreed deadlock resolution mechanisms, would exclude such risk completely, but it could also be misused by the absent partner to trigger, or to force the other partner to trigger, the deadlock

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[23] *Hewitt,* p. 242.

resolution mechanisms. Further, the question should be answered whether only meetings shall be considered at which a "deadlock matter" is on the agenda. This would reduce the scope of the deadlock resolution mechanisms by aligning such requirement to the situation where the partners cannot agree on a deadlock matter within a meeting.

Please refer to the following clause providing the respective wording to qualify the boycott of meetings as a deadlock matter:

EXAMPLE CLAUSE: BOYCOTT OF MEETINGS QUALIFIED AS A DEADLOCK

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.1.1 Deadlock. For the purpose of this clause, "**Deadlock**" shall be deemed to have occurred if:

(a) [*intentionally left blank*]; or

(b) a quorum is not present at [two] successive duly convened meetings of the Managing Directors, the Supervisory Board or the shareholders [(being, in each case, a meeting at which a Deadlock Matter was on the agenda to be decided)] by reason of the absence from that meeting of the same shareholder, or in the case of a meeting of the Supervisory Board or the Managing Directors, a person nominated as a Supervisory Board Member or Managing Director by that same Partner, respectively.

Please refer to the following clause providing the respective wording to qualify the second meeting as a meeting with a quorum regardless of the presence of the "blocking" shareholder. This example of a clause covers only the prevention of a deadlock on the shareholders level, but could also be drafted for other company levels, accordingly. However, on the supervisory board level and management board level it is more common to structure the quorum differently, for example, by granting a casting vote.

EXAMPLE CLAUSE: QUORUM

3 CORPORATE GOVERNANCE

3.1 CORPORATE BODIES OF THE COMPANY

3.2 SHAREHOLDERS' MEETING

3.2.1 General Competencies. [reference is made to "Example Clause: Corporate Bodies" in Section C.II above]

3.2.2 Actions Requiring Shareholders' Meeting Approval. [*intentionally left blank*]

3.2.3 Voting. [reference is made to "Example Clause: Corporate Bodies" in Section C.II above]

3.2.4 Quorum. The Articles shall contain customary procedures for meetings and resolutions of the Shareholders' Meeting of the Company. The Shareholders' Meeting shall have a quorum if it has been duly convened and if 75% (seventy-five per cent) or more of the share capital is represented. If the Shareholders' Meeting has no quorum, another Shareholders' Meeting with the same agenda shall be convened without undue delay (*unverzüglich*) at fourteen (14) calendar days' notice. Such Shareholders' Meeting has a quorum regardless of the percentage of the represented share capital, provided all formalities have been complied with in calling the meeting. The second invitation must indicate this fact.

4. Trigger of the Deadlock Mechanisms

Finally, it should be considered whether the agreed deadlock resolution mechanisms shall commence (i) immediately upon the occurrence of a deadlock; or (ii) only upon the receipt of a (written) notice served from one partner to the other(s) stating that, in its opinion, a deadlock has occurred – a ***Deadlock Resolution Notice***.

Please refer to the following example providing an escalation mechanism, which shall commence immediately after the occurrence of a deadlock, declaring that high-ranking executives of the joint venture partners, and if necessary high-ranking executives of their shareholders in a second escalation stage, shall try to resolve the dispute firstly, before more serious deadlock resolution mechanisms shall come into action:

EXAMPLE CLAUSE: IMMEDIATE COMMENCEMENT

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.2 ESCALATION MECHANISM

In the event of a Deadlock, the matter in dispute shall be first submitted to the attention of the chief executive officers of the Partners who shall try to reach a solution within …

[for the complete wording of such clause, reference is made to the "Example Clause: Escalation Mechanism" set forth in this Section D.V.2.a) below]

6.3 DEADLOCK RESOLUTION

6.3.1 Deadlock Resolution Notice. [*intentionally left blank*]

Looking at this example of a clause, it can be noted that only the escalation mechanism shall start automatically without the requirement of a further notice. Further deadlock resolution mechanisms, in particular any exit mechanism if agreed upon, shall still require a deliberate action by a joint venture partner in the form of a (written) notice

served from one partner to the other. Even if, it is in principle conceivable that an exit mechanism shall also commence after the occurrence of a deadlock automatically without any further notice, there is no advantage that the joint venture partners waive the option to decide actively whether or not an agreed exit mechanism with its strict consequences shall be implemented.

However, the joint venture partners can include such (automatically triggering) preservation mechanisms to ensure, or at least to incentivize, their representatives in the different company bodies that they cooperate and do their utmost to resolve outstanding issues between them on the respective level.

The following example of a clause requires the service of a notice from one partner to the other in order to initiate any of the agreed deadlock mechanisms, *i.e.*, preservation mechanisms or exit mechanisms:

EXAMPLE CLAUSE: COMMENCEMENT AFTER NOTICE

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.1.1 Deadlock Matter. [*intentionally left blank*]

6.1.2 Deadlock. [*intentionally left blank*]

6.1.3 Deadlock Notice. Either Partner may within [twenty-eight (28)] calendar days after the occurrence of a Deadlock (the first day being the day after the day on which the Deadlock occurred) serve notice on the other Partner:

(a) stating that in its opinion a Deadlock has occurred; and

(b) identifying the matter giving rise to the Deadlock

(a "**Deadlock Notice**").

6.2 PRESERVATION MECHANISM

[reference is made to the different examples of clauses providing "Preservation Mechanisms" set forth in Section D.V below]

6.3 DEADLOCK RESOLUTION

6.3.1 Deadlock Resolution Notice. [*intentionally left blank*]

V. Preservation Mechanisms

One way to solve a dispute between joint venture partners is to agree on mechanisms which facilitate the process of finding a solution, either by promoting the dialogue between them, or by setting up rules pursuant to which the matter in dispute shall be finally decided, in order to preserve the joint cooperation – ***Preservation Mechanisms***.

Preservation mechanisms can, therefore, be categorized into two different groups: On the one hand, there are mechanisms which try to facilitate an agreement between the joint venture partners, in particular by including one or more of the following mechanisms:

(i) a "cooling-off" period (as described in Section D.V.1);

(ii) a dispute resolution mechanism in the form of an escalation mechanism (as described in Section D.V.2.a));

(iii) a dispute resolution mechanism in the form of mediation proceedings (as described in Section D.V.2.b));

(iv) sole risk and non-consent clauses (as described in Section D.V.3).

These preservation mechanisms ((i) to (iv)) have in common that they seek to stimulate reflection on the matter in dispute and search for an agreement, either on the level of the company body where the dispute arose or a higher level, *i.e.*, an agreement by and between the joint venture partners or their shareholders.[24]

On the other hand, the partners can also agree upon an additional decision-taking process where the matter in dispute will be decided finally, in particular by including one or more of the following mechanisms:

(v) a dispute resolution mechanism in the form of arbitration proceedings (as described in Section D.V.2.c));

(vi) substantive regulations (as described in Section D.V.4);

(vii) a casting vote (as described in Section D.V.5);

(viii) an additional company body taking the decision (as described in Section D.V.6);

(ix) the company's management taking the decision (transfer of responsibilities) (as described in Section D.V.7.a));

(x) the company's management taking the decision (composition of the management) (as described in Section D.V.7.b));

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[24] *Campbell/Alibekova*, p. 221 *et seq*.

(xi) the company's management taking the decision ("two to hire, one to fire" principle) (as described in Section D.V.7.c)).

The decision-taking processes listed in this group of preservation mechanisms ((v) to (xi)) have in common that each of them resolves the conflict between the joint venture partners finally without having reached a consent between them. However, they are entirely different in terms of how and when such decisions are made: substantive regulations determine how the matter in dispute shall be decided at the time the partners enter into the joint cooperation, while in all other mechanisms, except the "two to hire, one to fire" principle which can only be used to impinge on future decision-making processes, the matter in dispute will be decided once the dispute has arisen.

Some of these different preservation mechanisms can be combined with each other, while others are mutually exclusive.

1. "Cooling-off" Period

If a disagreement between the members of a company body about whatsoever matter has arisen, it could be useful if the joint venture agreement provides a period of time in which the members of the relevant company body can step back and think about the matter in dispute and how it could be resolved – a ***"Cooling-off" Period***. In this "cooling-off" period, which can take from several days to weeks, the joint venture partners are not faced with any adverse consequences, so it gives the respective persons the possibility to discuss the matter internally with the appropriate senior level or third-party experts in order to find out whether there is leeway for negotiations and, if so, which compromise can be offered to the other joint venture partner on the respective company body level.

In case that the relevant representatives are not able to come to an agreement within the respective time period, further deadlock resolution mechanisms might come into play, either directly after the expiration of the "cooling-off" period or after service of a notice by one of the joint venture partners to the other(s).

Please refer to the following clause providing a fourteen (14) calendar days' "cooling-off" period and the requirement that a notice has to be sent in order to trigger further deadlock resolution mechanisms:

EXAMPLE CLAUSE: "COOLING-OFF" PERIOD[25]

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.2 COOLING-OFF PERIOD

6.2.1 Cooling-off Period. The Partners undertake that following service of the Deadlock Notice and for a period of fourteen (14) calendar days thereafter (the first day being the day after the receipt of the Deadlock Notice) (the "**Cooling-off Period**") the members of the relevant company body shall use their [best | reasonable] efforts to resolve their differences amicably and in good faith.

6.2.2 No Resolution. If the relevant company body is unable to reach a solution of the Deadlock within the Cooling-off Period then either Partner may serve a Deadlock Resolution Notice as set forth in Section 6.3.1 within twenty-eight (28) calendar days after the expiry of the Cooling-off Period.

6.3 DEADLOCK RESOLUTION

6.3.1 Deadlock Resolution Notice. [reference is made to "Example Clause: Russian Roulette" set forth in Section D.VI.3 below]

2. Dispute Resolution Mechanisms

Another way to resolve, or at least to facilitate the resolution of, a deadlock situation is the inclusion of a dispute resolution mechanism.[26]

This could refer to an internal dispute resolution mechanism in the form of a tiered escalation mechanism pursuant to which the matter in dispute will be addressed to high-ranking executives of the joint venture partners and/or high-ranking executives of their shareholders (as described under lit. a) below). On the other hand, it could refer to external dispute resolution mechanisms, whereby it can be differentiated between (i) alternative dispute resolution proceedings, in particular mediation pursuant to which a third party tries to mediate between the partners (as described under lit. b) below); and (ii) arbitration proceedings where the matter in dispute will be decided by a third party (as described under lit. c) below).

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[25] *Hewitt*, p. 762.
[26] *Robles y Zepf/Girnth/Stumm*, BB 2016, 2947 (2947).

a) Escalation Mechanism

A common approach to minimize the risk that serious deadlock resolution mechanisms will be triggered thoughtlessly and too quickly is the provision of a mechanism pursuant to which in the event of an irresolvable disagreement the matter in dispute has to be escalated by the respective company body to a higher decision-making level before a joint venture partner is allowed to execute other mechanisms, in particular an exit mechanism – an ***Escalation Mechanism***.

If there is a dispute among the managing directors, the matter in dispute shall usually be first submitted through a tiered procedure to the attention of another company body, *i.e.*, to the attention of a supervisory/advisory board or the shareholders' meeting (as already described in Section D.IV above).

In addition to, or as an alternative to, such an "internal" tiered procedure, an "external" escalation mechanism can be provided that the matter in dispute shall be escalated to high-ranking executives of the joint venture partners (*e.g.*, chief executives officers, chief financial officers, etc.), and/or, provided that there are appropriate group structures, to high-ranking executives of the joint venture partners' parent companies.

The pressure on the managing directors and/or board members created by such an escalation mechanism in form that they have to liaise with and to report to the relevant persons in their companies or group companies indicating that they were not be able to solve the matter in dispute usually strongly encourages them to find a solution between them.[27]

Should such incentive not be sufficient and the matter in dispute need to be submitted to a higher level, the persons responsible might maybe be able to assess and discuss the problem in an unbiased manner in order to find a proper solution.[28]

For the case that the dispute cannot be settled on the (last) escalation level, the (tiered) escalation mechanism either can refer to another deadlock resolution mechanisms or the following procedure may not be regulated so that the general rule applies, *i.e.*, the

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[27] *Elfring*, NZG 2012, 895 (897); *Hewitt*, p. 245.
[28] *Elfring*, NZG 2012, 895 (897).

matter in dispute will be deemed as rejected since the required consent could not be achieved.

Please refer to the following example of a clause which provides an tiered escalation mechanism consisting of two escalation levels, which will start automatically after the occurrence of a deadlock without any further notice:

EXAMPLE CLAUSE: ESCALATION MECHANISM[29]

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.2 ESCALATION MECHANISM

In the event of a Deadlock, the matter in dispute shall be first submitted to the attention of the chief executive officers of the Partners who shall try to reach a solution within twenty-eight (28) calendar days from such submission (the first day is the day after the day of submission). If they are not able to resolve the disputed [matter | Deadlock Matter], then such matter shall be submitted for consideration to the chief executive officers of the Partners' shareholders who shall try to reach a solution within another twenty-eight (28) calendar days from such submission (the first day is the day after the day of submission) (these two escalations herein referred to as the "**Escalation Mechanism**");

(a) if such persons agree upon a resolution of the disputed [matter | Deadlock Matter] within the applicable twenty-eight (28) calendar days' period, they shall sign a statement setting out the terms of the resolution, and the Partners shall exercise their voting rights and use, to the extent legally permissible, their influence on the Shareholders' Meeting, the Supervisory Board and/or the Managing Directors and otherwise in relation to the Company to procure that the resolution or disposition is fully and promptly carried into effect; or

(b) if such persons are not able to agree on the disputed [matter | Deadlock Matter] within the applicable second twenty-eight (28) days' period, then any Partner may serve to the other a Deadlock Resolution Notice as set forth in Section 6.3.1 within twenty-eight (28) calendar days after the expiry of the total fifty-six (56) calendar days' period.

6.3 DEADLOCK RESOLUTION

6.3.1 Deadlock Resolution Notice. [reference is made to "Example Clause: Russian Roulette" set forth in Section D.VI.3 below]

[29] Wording based on: *Hewitt*, p. 759.

b) Mediation

Besides the common dispute resolution mechanisms like litigation and arbitration, there are many forms of alternative dispute resolution (ADR) mechanisms including conciliation, mediation, mini-trial, nonbinding arbitration, early neutral evaluation or a combination of more than one form.[30] Because mediation is the most popular form of ADR, it should be discussed in more detail.

Mediation – is a flexible and consensual technique in which a neutral facility (the mediator) helps the parties to reach a negotiated settlement of their dispute. The parties have control over the decision to settle and the terms of any agreement. Settlements are contractually binding and widely enforceable.[31]

There are two different types of mediation which can be distinguished. On the one hand, *institutional mediation* which means that the mediation proceedings are administered by an international mediation institution and are being governed by the rules of such institution. On the other hand, *ad hoc mediation* which means that no such international mediation institution is involved, while the proceedings are governed by rules which have been particularly set out by and between the parties. Due to its widespread use, the following explanations relate mainly to institutional mediation proceedings.

With respect to joint ventures, where the joint venture partners have an ongoing business relationship, mediation proceedings can be used in the event of a deadlock to prevent the mutual understanding and confidence between the partners necessary for an ongoing joint business. In contrast to confrontational proceedings like arbitration or litigation, the third party does not decide the dispute so that neither partner has to accept a certain decision.[32] During the mediation, an impartial and neutral mediator can help the partners to reduce any existing prejudices and misunderstandings in order to understand each other's point of view and interests. By taking into account all existing aspects of the dispute (legal, economic and personal), mediation proceedings can facilitate the finding of a comprehensive solution.[33]

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30 *Hewitt*, p. 327.
31 International Chamber of Commerce (ICC), available at *https://iccwbo.org/dispute-resolution-services/mediation/*, accessed on 18 February 2018.
32 *Robles y Zepf/Girnth/Stumm*, BB 2016, 2947 (2948).
33 *Fett/Spiering*, chap. 9, para. 111.

In addition to the facts that the ongoing business relationship can be protected and the joint venture partners have control about the mediation proceedings, a further advantage is that mediation proceedings are confidential. Mediation (as well as arbitration) proceedings are carried out in private, so that the involved parties can minimise the risk of adverse publicity and disclosing business information.[34]

In order to ensure that the mediator will be accepted by all joint venture partners and the work environment will be constructive, the mediator should be nominated by the partners consensually. For the case that a consensus cannot be found, a provision should be included in the respective underlying agreement pursuant to which the chosen institution shall determine a suitable person as mediator. Most of the commonly used mediation rules provide such a procedure.[35]

As an voluntary process, mediation proceedings can be terminated by any party without any reason and without any consequences in order to settle the dispute by a different procedure.[36] Even if the joint venture partners use their best efforts to find a solution, there might be situations where the opposing interests cannot be balanced and the conflict cannot be resolved. For this reason, mediation should not be the only deadlock resolution mechanism. It should be complemented by other mechanisms which can finally resolve the deadlock situation in any case without the agreement of all partners, such as arbitration or exit mechanisms.

Besides the fact that mediation possibly cannot dissolve an existing dispute between joint venture partners, a further disadvantage of (external) mediation proceedings is the administrative effort. Even if mediation proceedings are more time- and cost-efficient as arbitration or litigation proceedings, the uncertain outcome of mediation proceedings reduces such cost-benefit advantage.[37]

Please refer to the following example of a clause which provides mediation proceedings governed by mediation rules of the International Chamber of Commerce (ICC):

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[34] *Hewitt*, p. 327 *et seq*.
[35] For instance: Article 5 (Selection of the Mediator) of the Mediation Rules of the International Chamber of Commerce.
[36] *Fett/Spiering*, chap. 9, para. 108.
[37] *Robles y Zepf/Girnth/Stumm*, BB 2016, 2947 (2948).

EXAMPLE CLAUSE: MEDIATION[38]

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.2 MEDIATION

6.2.1 General. Following the service of a Deadlock Notice, the Deadlock shall be first referred to, and tried to be resolved by, mediation proceedings under the Rules of Mediation of the International Chamber of Commerce in the respective current version (the "**ICC Mediation Rules**").

6.2.2 Appointment of Mediators. The Partners shall mutually select and appoint a person who shall act as mediator. If the Partners are not able to agree upon a mediator within twenty-eight (28) calendar days from the receipt of the Deadlock Notice (the first day is the day after the day of receipt), then the mediator shall be selected and appointed in accordance with the ICC Mediation Rules.

6.2.3 No Resolution. If the Deadlock has not been settled pursuant to the ICC Mediation Rules within [forty-two (42)] calendar days following the filing of a Request for Mediation pursuant to, and as defined in, the ICC Mediation Rules or within such other period as the Partners may agree in writing, [such Deadlock shall thereafter be finally resolved under the Rules of Arbitration of the International Chamber of Commerce in the respective current version (the "**ICC Arbitration Rules**") in accordance with Section [*ARBITRATION CLAUSE*] │ either Partner may serve a Deadlock Resolution Notice as set forth in Section 6.3.1 after the expiry of the [forty-two (42)] calendar days' period].

6.3 DEADLOCK RESOLUTION

6.3.1 Deadlock Resolution Notice. [reference is made to "Example Clause: Russian Roulette" set forth in Section D.VI.3 below]

c) Arbitration and Litigation

Arbitration – is a non-judicial process for the settlement of disputes where an independent third party (an arbitrator) makes a decision that is binding.[39]

There are two different types of arbitration which should be distinguished: On the one hand, *institutional arbitration* which means that the arbitration proceedings are administered by an international arbitral institution and are being governed by the rules of

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[38] Based on the Suggested ICC Mediation Clause D (English version), available under: *https://iccwbo.org/publication/suggested-icc-mediation-clause-english-version*, accessed on 18 February 2018.

[39] The Chartered Institute of Arbitrators (CIArb), available at: *http://www.ciarb.org/dispute-appointment-service/arbitration/what-is-arbitration*, accessed on 18 February 2018.

such institution. On the other hand, *ad hoc arbitration* which means that no such international arbitration institution is involved, while the proceedings are governed by the UNCITRAL Rules or by rules which have been particularly set out by and between the parties.[40] Due to its widespread use, the following explanations relate mainly to institutional arbitration proceedings.

In contrast to mediation proceedings, the third party, *i.e.*, the arbitrator, has the power to make a final binding decision dissolving the deadlock between the joint venture partner. Such advantage of arbitration proceedings is also a disadvantage for the joint venture partners since their influence on the procedure is limited and they have no control over the decision.

Disputes between joint venture partners are regularly based on questions which are driven by the different interests of the joint venture partners and, therefore, cannot be decided objectively correctly or incorrectly.[41] This is the reason why joint venture partners often refuse to hand over the power to decide such commercial or strategic (discretionary) decisions to a third party.[42] Therefore, it is preferable in most joint ventures to distinguish between deadlocks which are based on matters in dispute which can/shall be decided by a third party and matters in dispute which cannot/shall not be decided by a third party. One way to address such problem is that only the matters in dispute solvable by a third party shall be applicable to the dispute resolution mechanism in form of arbitration proceedings or a tiered mechanism (internal escalation – mediation – arbitration), while other matters in dispute shall trigger other (more severe) deadlock mechanisms. Another way is that the joint venture partners, according to the joint venture agreement, have to find a consensus whether or not the matter in dispute should be applicable to arbitration proceedings. Having said this, arbitration is most suitable for deadlock situations where legal questions have to be decided or where the deadlock is based on factual or technical matters in dispute which can be decided by a third party expert. However, it can be difficult to find a competent arbitrator who has the required knowledge and experience to decide the matter in dispute,

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40 *Hewitt*, p. 336.
41 *Robles y Zepf/Girnth/Stumm*, BB 2016, 2947 (2948).
42 *Robles y Zepf/Girnth/Stumm*, BB 2016, 2947 (2948).

or even in a mediation, a mediator who is able to support the partners in finding a suitable solution.[43]

Beside such disadvantages of arbitration, there are certain advantages: (i) the arbitration process is private and confidential; (ii) the arbitration procedure can be chosen freely by the parties, including the venue and language of the arbitration, and the number and personal requirements of the arbitrators; (iii) arbitration is usually a more cost- and time-sufficient than litigation; (iv) subject to any provisions of the chosen governing law and arbitration rules, the arbitration decision is final and binding; and (v) arbitral awards are enforceable internationally through the New York Convention on the Recognition and Enforcement of Arbitral Awards 1958 (New York Convention).[44]

Arbitration clauses should also be included in the joint venture company's articles of association in order to ensure that the joint venture company is also bound by the chosen procedure.[45]

Please refer to the following example of a clause which provides arbitration proceedings governed by arbitration rules of the International Chamber of Commerce (ICC):

EXAMPLE CLAUSE: ARBITRATION[46]

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.2 [MEDIATION]

6.3 ARBITRATION

6.3.1 General. [In case a Deadlock could not be settled through mediation proceedings in accordance with Section 6.2 | Following the service of a Deadlock Notice], the Deadlock shall be referred to, and finally resolved by, arbitration proceedings under the Rules of Arbitration of the International Chamber of Commerce in the respective current version (the "**ICC Arbitration Rules**").

6.3.2 Number of Arbitrators. [The Deadlock shall be resolved by [one (1) arbitrator | three (3) arbitrators]. | If the amount in controversy is equal to or less than [EUR 500,000 (in words: Euro five hundred thousand)], the Deadlock shall be resolved by one (1) arbitrator and for all other Deadlocks by [three (3)] arbitrators.]

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[43] *Schulte/Pohl*, para. 671 *et seq*.
[44] *Hewitt*, p. 333 *et seq*.; American Bar Association, p. 1191.
[45] *Quinke*, NZG 2015, 537 (545 *et seq.*).
[46] Based on the Standard ICC Arbitration Clause (English version), available under: *https://iccwbo.org/dispute-resolution-services/arbitration/arbitration-clause/*, accessed on 18 February 2018

The arbitrator[s] shall be selected and appointed in accordance with the ICC Arbitration Rules.

6.3.3 Place of Arbitration. The seat (legal place) of arbitration shall be [Frankfurt am Main, Germany].

6.3.4 Governing Law. The governing law of this contract shall be the substantive law of [Germany].

6.3.5 Language of Arbitration. The language to be used in the arbitral proceedings shall be [English]. [Pieces of evidence are also admissible in the [German] language.]

6.3.6 Fees and Expenses. The fees of the arbitrator[s] and the expenses incident to the proceedings shall be borne by the [losing Partner | Partners equally]. The reasonable fees of respective counsel engaged by the Partners, and the fees of expert witnesses and other witnesses called for the Partners, shall also be paid by the [losing Partner | Partners equally].

6.3.7 Interim Relief. This arbitration agreement does not exclude the right of either Partner to request preliminary measures respectively interim measures of protection, *e.g.*, arrest in rem and/or preliminary (issued before the court judgment) orders etc., before the competent (irrespective of the place of arbitration) court, before or after commencement of the arbitration proceedings. The request for such preliminary measures before the respective court does not limit the power of the respective arbitration authority.

3. Business Option Rights (Call-/Deny Options)

Especially in joint ventures where the partners try to mitigate their costs, risks and benefits for different individual projects by pooling their resources, it is likely that there will be situations in which they disagree to invest in specific business opportunities, either in case that (i) the required voting majority cannot be reached; (ii) a (minority) shareholder has exercised a veto right; or (iii) a minority has been overruled by the majority.

For such situations, it might be useful if the joint venture partners have agreed upon so-called “sole risk clauses” and/or “non-consent clauses” granting the defeated partner the right to take or to deny the business opportunity – ***Business Option Rights***. Such business option rights can commonly be found in joint operating agreements in the oil and gas industry establishing contractual joint ventures,[47] but under certain circumstances it could also be conceivable to use such clauses in an equity joint venture, in particular in multi-party joint ventures.

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[47] *Marshall*, JABS 2016, 214 (217).

If the joint venture partners cannot agree upon a new business opportunity (*e.g.*, to open up a new sales market or to scrutinise a specific drug), the joint venture agreement may stipulate that the partners who are in favour of the proposed but declined investment opportunity are allowed to pursue such investment alone on their sole risk without the participation of the joint venture company or the dissenting joint venture partners – a ***Sole Risk Clause*** granting a ***Business Call Option***.[48] This option can be granted with or without the requirement that the consent of the other joint venture partners is required. Besides the fact that such clause can serve as a "deadlock-breaker", it also provides an incentive for the joint venture partners to reach an agreement, since otherwise the other (minority) partner has the right to take the relevant business opportunity alone.[49]

Since the joint venture partners are usually bound by a non-compete clause which states that each of them shall not undertake or be interested in any business in competition with the joint venture company, it is necessary to include a corresponding regulation in the joint venture agreement.

Please refer to the following example of a sole risk clause which can only give a first impression how such type of clauses can be drafted. Depending on the circumstances of the proposed joint venture, there are a number of economic, legal and tax issues to be considered when drafting the joint venture agreement:

EXAMPLE CLAUSE: SOLE RISK CLAUSE[50]

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.2 SOLE RISK CLAUSE

In the event of a Deadlock due to a disagreement between the Partners about seizing a business opportunity within the scope of the joint venture and either X-GmbH or Y-(Pty) Ltd wishes to pursue this business opportunity alone, such Partner (the "**Proposing Partner**") shall propose such business opportunity to the other Partner (the "**Non-Consenting Partner**") in the context of the Shareholders' Meeting. If the Non-Consenting Partner decides not to pursue such business opportunity, as evidenced by its negative vote in the

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48 *Campbell/Alibekova*, p. 136 *et seq.*; *Zuofa*, p. 4.

49 *Saville*, AMPLA Yearbook 1986, 224 (226).

50 Based on the sole development sample clause (License Agreement (Bristol Myers Squibb Co)), available under: *https://www.lawinsider.com/clause/sole-development*, accessed on 18 February 2018.

Shareholders' Meeting with respect to such business opportunity, then, upon request of the Proposing Partner, the Shareholders' Meeting shall decide whether the Proposing Party may proceed alone with such business opportunity, whereby the consent of the Non-Consenting Partner shall not be unreasonably withheld. If the Shareholders' Meeting agrees to permit such sole pursuance of the business opportunity, the Proposing Party shall be entitled to undertake such business opportunity at its sole cost and expense.

For the avoidance of doubt, the Company shall not be involved in any business related to the business opportunity pursued by the Proposing Party, except as otherwise mutually agreed by the Partners in writing.

6.3 [PRESERVATION MECHANISMS]

6.4 DEADLOCK RESOLUTION

In contrast thereto, in a situation where the majority votes in favour of a proposed business opportunity against the will of a minority, the joint venture agreement may grant the right to the overruled joint venture partner(s) not to participate in the relevant project – a ***Non-consent Clause*** granting a ***Business Deny Option***.[51]

Due to the structure of an equity joint venture, the risks and returns related to the relevant project are beard by the joint venture company and, therefore, by all joint venture partners as shareholders of the company (*i.e.*, consenting and non-consenting partners). Even if the project are conducted by a (new established) subsidiary of the joint venture company in order to reduce such risks, the structural shortcomings limit the applicability of non-consent clauses in equity joint ventures. Further, it would also be necessary to adapt the company's accounting in order to ensure that costs and expenses related to the project in question on the one hand as well as the gained profits on the other hand could be allocated only to the consenting joint venture partners.

Please refer to the following example of a non-consent clause, which is drafted, as an exception to the Draft structure, for a multi-party joint venture and, therefore, "Partners" means more than two joint venture partners where one or more joint venture partner together are holding the majority of the joint venture company. Here, too, this example can only give a first impression how such type of clauses can be drafted.

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[51] *Marshall*, JABS 2016, 214 (218 *et seq.*); *Zuofa*, p. 4.

EXAMPLE CLAUSE: NON-CONSENT CLAUSE[52]

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.2 NON-CONSENT CLAUSE

6.2.1 Non-Consent Clause. In the event that not all Partners, but the required majority of the Partners in the Shareholder's Meeting, agree on a proposed business opportunity, any Partner who has voted against the business opportunity has the right to choose not to participate in the proposed business opportunity (the "**Non-Consenting Partner**"). The Non-Consenting Partner shall not be obligated to bear any costs or expenses, and shall not be entitled to any share of proceeds, associated with the relevant business opportunity. [However, the Non-Consenting Party has the right to join the Partners who has voted in favour of the business opportunity (a "**Consenting Partner**", and together, the "**Consenting Partners**") and to participate in the relevant business opportunity at a later stage provided that each Consenting Partner has been compensated with payment of 200% of its costs and expenses it incurred in relation to the business opportunity.]

6.2.2 Accounting Rules. [*intentionally left blank*]

6.3 [PRESERVATION MECHANISMS]

6.4 DEADLOCK RESOLUTION

Although it seems *prima facie* that sole risk and non-consent clauses are in contradiction to the purpose of joint ventures, namely the cooperation by sharing risks, costs and benefits, such clauses can be used to ensure the vitality of the joint cooperation where business opportunities can also be pursued by certain joint venture partners without the agreement of all partners.[53]

4. Substantive Regulations

Deadlocks can also be prevented or resolved if the joint venture partners have agreed on substantive regulations about potential deadlock matters when entering into the venture.[54] This makes it necessary that the future partners must, at the time they enter into the joint cooperation, identify the matters which likely bear the potential risk to develop into an indissoluble conflict between them during the cooperation. After identifying these potential deadlock matters, they can agree on provisions to be included

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[52] Based on the non-consent sample clause (Participation Agreement (New Frontier Energy Inc)), available at: *https://www.lawinsider.com/clause/non-consent*, accessed on 18 February 2018.

[53] *Marshall*, JABS 2016, 214 (218 *et seq.*); *Zuofa*, p. 4.

[54] *Fett/Spiering*, para. 526.

in the joint venture agreement and/or the articles of association of the joint company stipulating how such matters should be handled in the event of a conflict – ***Substantive Regulations***.[55]

The agreement may, for example, provide that (i) in the event of a disagreement about the appropriation of the joint venture company's profits (distribution of dividends or retention of earnings), 50% of the yearly earnings should be distributed and 50% should be retained; or (ii) in case the partners cannot agree on the adoption of the annual budget, the annual budget of the previous year shall apply.[56]

However, the agreement of such substantive regulations should be considered carefully. On the one hand, it is not feasible to identify each potential deadlock matter or to find a proper solution of any of the identified matters in advance. On the other hand, the partners reduce their flexibility to discuss these matters controversially if and when they arise and they are not able to take into account the conditions at the time.[57]

Please refer to the following example of a clause which provides substantive regulations with respect to the appropriation of profits and the adoption of the annual budget:

EXAMPLE CLAUSE: SUBSTANTIVE REGULATIONS

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.2 SUBSTANTIVE REGULATIONS

6.2.1 Dividend Policy. To the extent permitted by applicable law, and unless otherwise agreed by the Partners, the Partners shall use [reasonable | best] efforts to maximize profits available for distribution by the Company to the Partners and to follow a dividend policy consisting of the distribution of a fixed annual dividend [of at least | equivalent to] [50% (in words: fifty per cent)] of such profits, which shall be distributed proportionally between the Partners on the basis of their participation in the share capital of the Company [, provided that any such distribution shall, unless otherwise agreed by the Partners, be carried out after full repayment of all loans, loan capital, borrowings and indebtedness in the nature of borrowings outstanding to the Company from the Partners (together with any accrued interest)].

6.2.2 Adoption of Annual Budget. In case the Managing Directors are being unable to validly resolve on the adoption of the annual budget or any amendment

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[55] Wachter/*Reinhard*, chap. 12, para. 49; Schulte/Schwindt/Kuhn/*Kuhn*, § 8 para. 2; *Elfring*, NZG 2012, 895 (896).

[56] *Fett/Spiering*, para. 526.

[57] *Elfring*, NZG 2012, 895 (896).

thereof by the date falling [three (3) | six (6)] months after the start of any calendar year, the annual budget of the previous year shall apply.

5. Casting Vote

Another straight-forward option to prevent or resolve a deadlock situation is granting an additional vote to a specific person, committee or additional company body [58] in the event of a tied vote enabling the respective person or body to decide the matter in dispute and to prevent/resolve the occurrence of a deadlock – a ***Casting Vote***.[59] This mechanism is usually used only for the decision-making process on the management level where the daily business decisions are made. The casting vote can be granted either internally to (i) a member of the management of the joint venture company (*e.g.*, the chief executive officer), (ii) the chairman of the supervisory or advisory board; or externally to (iii) a third party from outside of the company.

For the decision-making processes in other company bodies dealing with the fundamental and strategy matters, in particular the shareholders' meeting but also a supervisory or advisory board, this mechanism is usually not appropriate. Either there is a majority/minority ratio in the joint venture where a casting vote is not necessary, or there is a 50/50 joint venture where a casting vote would thwart the ownership structure in a way that one partner would have the power to make the important decisions by using the casting vote.

With respect to granting the casting vote to a partner's representative, it is common to stipulate in the joint venture agreement and the company's articles of association that the respective person shall exercise the casting vote in good faith and in the interests of the joint venture company. But, regardless of such obligation, the joint venture partners other than the partner appointing the respective person with the casting vote are understandably concerned that their interests will not be considered by such person.

To reduce such advantage of that partner, which negates the concept of joint control, the partners can modify the preservation mechanism in three ways:

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[58] Regarding granting a casting vote to an additional company body or committee, please refer to Section D.VI.6.

[59] MüHaGesR I/*Wirbel*, § 28 para. 59.

(i) the casting vote can be granted subject to ***objective criteria***, *e.g.*, the casting vote will be granted to the joint venture partner who provides a shareholder loan in a specific amount;[60]

(ii) the casting vote can be allocated among the joint venture partners ***by subjects***, whereby the partner more competent in the relevant subject obtains the casting vote.[61] Such an allocation is problematic with respect to important, strategic and thematically comprehensive decisions; or

(iii) the casting vote can be allocated among the joint venture partners ***periodically***, *i.e.*, each joint venture partner obtains the casting vote for a determined time period, for instance, one (1) business year.[62] Such an allocation entails the risk of abuse that decisions will be delayed or accelerated without objective cause.[63]

With respect to granting the casting vote to a third party, it should firstly be noted that it is normally not the joint venture partners' intention to outsource the decision-making competency to a third party, losing control over the (fundamental) decisions regarding the company's business.[64] However, in most cases, it might be difficult to find a third party who is neutral and enjoys the confidence of all joint venture partners.[65] Further, the principle of sovereignty of associations (*Grundsatz der Verbandssouveränität*) under German Corporate law has to be complied with. According to this principle, it is prohibited to transfer the power of final decision on essential issues concerning a company from the shareholders' meeting as company organ to a third party from outside of the company.[66] Since the joint venture partners are not allowed to grant a casting vote to a third party with respect to the decision on essential issues of the company, in particular, decisions regarding capital measures, measures under the German Transformation Act (*Umwandlungsgesetz – UmwG*), the liquidation of the company, etc., the scope of such preservation mechanism, *i.e.*, granting a casting vote to a third party, should be limited to daily business decisions on the management level.[67]

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60 *Robles y Zepf/Girnth/Stumm*, BB 2016, 2947 (2949).
61 *Elfring*, NZG 2012, 895 (897); Schulte/Schwindt/Kuhn/*Kuhn*, § 8 para. 11.
62 *Hewitt*, p. 244.
63 *Schulte/Pohl*, para. 670; Schulte/Schwindt/Kuhn/*Kuhn*, § 8 para. 12; *Fett/Spiering*, p. 593.
64 *Fett/Spiering*, p. 593.
65 *Hewitt*, p. 244.
66 *Holler/Frese*, BB 2014, 1479 (1481); Michalski/*Römermann*, § 45 para. 19; MüKoGmbHG/*Liebscher*, § 45 para. 41.
67 *Holler/Frese*, BB 2014, 1479 (1481); *Kallrath*, Notar 2014, 75 (79).

Irrespective of the selected structure (granting a casting vote internally or externally), the underlying disagreement of the partners will not be solved by this deadlock resolution mechanism. Rather, one partner has to accept the decision made by exercising the casting vote, *i.e.*, the opinion of the partner who controls the relevant board member. The underlying conflict will still exist and can (subconsciously) strain the future relationship of the joint venture partners.

Please refer to the following example of a clause which provides a casting vote on management level granted to the chief executive officer of the company:

EXAMPLE CLAUSE: CASTING VOTE – MANAGING DIRECTORS

3 CORPORATE GOVERNANCE

3.1 CORPORATE BODIES OF THE COMPANY

3.2 SHAREHOLDERS' MEETING

3.3 SUPERVISORY BOARD

3.4 MANAGING DIRECTORS

3.4.1 Appointment. [reference is made to the "Example Clause: Corporate Bodies" under Section C.II above]

3.4.2 Power of Representation. [*intentionally left blank*]

3.4.3 Removal. [reference is made to the "Example Clause: Corporate Bodies" under Section C.II above]

3.4.4 Voting. Resolutions of the Managing Directors as a body are adopted with the single majority of the votes cast or, outside of meetings, with the simple majority of the Managing Directors. The chairperson of the meetings, the chief executive officer (the "**CEO**"), shall have a casting vote.

3.4.5 Casting Vote. If a disagreement arises at a meeting of the Managing Directors, the CEO shall use his/her best efforts to reconcile the different opinions of the Managing Directors. If the CEO is unsuccessful, the matter shall be decided by a simple majority vote of those present or represented including, if necessary, by use of the CEO's casting vote. The casting vote of the CEO shall be exercised by him/her in good faith in the interests of the efficient running of the Company.

3.4.6 Quorum. [*intentionally left blank*]

6. Additional Company Body (Dispute Review Panel)

According to Sect. 52 para. 1, 82 para. 2 no. 2 German Limited Liability Companies Act (*GmbH-Gesetz – GmbHG*), it is permissible to establish a voluntary company organ in addition to the obligatory company organs of a German liability company. Such an additional company organ (specially set up for this purpose or still existing) can be

used to settle disputes between joint venture partners on the management level as well as on the shareholders level.

There are three different forms how the corporate governance of a joint venture company can be structured in order to facilitate the resolution of deadlocks between joint venture partners by the establishment of an additional company organ:[68]

(i) Firstly, it can be stipulated that in the event of a deadlock, either on the management level or on the shareholders level, the additional company organ shall act as a mediator, trying to mediate the difference of opinion and suggesting solutions to the dispute – ***Internal Mediation***.

(ii) Secondly, it can be stipulated in accordance with German law that the responsibilities of the shareholders' meeting regarding the management of the company, including the right to issue instructions to the managing directors (*Weisungsrecht*), shall be transferred to the additional company body, and, therefore, such company body takes over all responsibilities of the shareholders' meeting regarding the management and supervision of the company's management – ***Transfer of Responsibilities***. Due to such transfer of responsibilities, disputes between the company's management will not be escalated to the shareholders' meeting and can be decided by the additional company body, issuing respective instructions to the managing directors.

As already set out in Section D.V.5 above, according to German law, the transfer of responsibilities is limited to the extent that the power of final decision on essential issues (fundamental transactions) concerning the company must retain to the shareholders' meeting.

(iii) Thirdly, it can be stipulated that in the event of a deadlock between the joint venture partners in the shareholders' meeting the additional company body has a casting vote, so that the relevant deadlock can be resolved by a decision of the additional company body on the matter in dispute – ***Casting Vote***.

To ensure that the additional company body is able to perform such duties, in particular to make the required decisions described under (ii) and (iii), special attention has to be

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[68] *Kallrath*, Notar 2014, 75 (80).

paid to the structure of the additional company body. In order to prevent that a deadlock can also arise between the members of the additional company body, it should consist of an odd number of members, whereby either all members can be appointed after joint proposal by the joint venture partners or the equal number of representatives are proposed by each joint venture partner separately and a further (neutral) member will be proposed by the members to be appointed.

If the additional company body shall be partially represented by representatives of the joint venture partners, *i.e.*, if it shall consist of an even number of members, a casting vote can be granted to the chairman of the company body, who will normally be elected from among the appointed members, in order to prevent or resolve deadlock situations. The casting vote could also be allocated among the joint venture partners subject to objective criteria, by subjects or periodically as explained in Section D.V.5 above.

Please refer to the following example of a clause which provides an advisory board consisting of three members whereby one member has to be proposed by the members to be appointed by the joint venture partners:

EXAMPLE CLAUSE: ADDITIONAL COMPANY BODY

3 CORPORATE GOVERNANCE

3.1 CORPORATE BODIES OF THE COMPANY

The Company shall have three (3) company bodies, namely:

(a) The shareholders' meeting (*Gesellschafterversammlung*) (the "**Shareholders' Meeting**");

(b) the advisory board (*Beirat*) (the "**Advisory Board**"); and

(c) the managing directors (*Geschäftsführung*) (the "**Managing Directors**").

3.2 SHAREHOLDERS' MEETING

3.3 ADVISORY BOARD

3.3.1 Composition. The Company shall have an advisory board comprising of three (3) members (each a "**Advisory Board Member**"). The Partners shall use their voting rights as shareholders of the Company, to the extent legally permissible, to ensure that the positions of such Advisory Board Members shall be appointed (*bestellt*) by the Shareholders' Meeting accordingly as follows:

(a) one (1) Advisory Board Member to be appointed (*bestellt*) without undue delay (*unverzüglich*) upon proposal by X-GmbH;

(b) one (1) Advisory Board Member to be appointed (*bestellt*) without undue delay (*unverzüglich*) upon proposal by Y-(Pty) Ltd;

(c) one (1) Advisory Board Member to be appointed (*bestellt*) without undue delay (*unverzüglich*) upon proposal by both Advisory Board Members to be appointed in accordance with subparagraphs (a) and (b).

3.3.2 Removal. Each Partner shall be entitled to request at any time the removal and replacement of the respective appointed representative as Supervisory Board Member in accordance with Section 3.3.1(a) or Section 3.3.1(b) (as applicable) and the other Partner shall upon such request vote in favour of the removal of such person as Supervisory Board Member. The Supervisory Board Member appointed in accordance with Section 3.3.1(c) may be removed and replaced by shareholders' resolution adopted with a majority of at least three quarters of the votes cast.

3.3.3 Voting. Each Advisory Board Member shall have one vote. Resolutions of the Advisory Board are passed with simple majority of the votes cast.

3.3.4 Quorum. [*intentionally left blank*]

Please refer to the following example of a clause which provides a casting vote to the additional company body in the event of a deadlock between the shareholders of the joint venture company:

EXAMPLE CLAUSE: ADDITIONAL COMPANY BODY'S CASTING VOTE[69]

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.2 ADDITIONAL COMPANY BODY'S CASTING VOTE

6.2.1 Casting Vote. Following the service of a Deadlock Notice, a Deadlock between the Partners in the Shareholders' Meeting shall be referred to, and finally resolved by a simple majority vote of, the members of the Advisory Board.

6.2.2 Scope. The Advisory Board has no competency and the proceeding as set out in Section 6.2.1 shall not apply, if the resolution has to be passed by the Shareholders' Meeting with a qualified majority, or if the Shareholders' Meeting is mandatorily responsible, according to statutory law, the articles of association or this joint venture agreement.

7. Management Structure

Finally, there are options to prevent deadlock situations in a joint venture company (i) on the shareholders level by granting additional powers to the company's management (as described under lit. a) below); and (ii) on the management level by structuring the

[69] Wording based on: *Kallrath*, Notar 2014, 75 (80).

management board appropriately (as described under lit. b) below); or granting specific rights regarding the appointment and removal of the managing directors (as described under lit. c) below).

a) Transfer of Responsibilities

In a German limited liability company, the shareholders' meeting is usually responsible for setting the company's long-term goals and business objectives and making the required fundamental decisions, while the management is responsible for the daily business. In order to reduce potentials of conflict between joint venture partners on the shareholders level and, therefore, the risk that a deadlock occurs, the responsibilities of the shareholders' meeting can be transferred to the company's management to the extent legally permissible (reference is made to the explanation set out in Section D.V.5 above) and the right to issue instructions to the managing directors (*Weisungsrecht*) can be waived – ***Transfer of Responsibilities***. Even if there are serious conflicts between the partners on the shareholder level, such a strong and independent management can ensure that the company remains able to conduct the joint business.[70]

This structure is only be effective and prevents deadlock situations on the shareholder level if the company has third-party managing directors who are independent from the joint venture partners. Otherwise, *i.e.*, if the joint venture partners want to be represented in the company's management, further regulations regarding the appointment and/or removal of the managing directors have to be included in order to ensure that deadlock situations between the joint venture partners can be prevented or resolved (reference is made to the following Subsection D.V.7.b).[71]

Please refer to the following example of a clause which grants extensive responsibilities to the management and sets out the managing directors' power of representation:

EXAMPLE CLAUSE: TRANSFER OF RESPONSIBILITIES[72]
3 CORPORATE GOVERNANCE
3.1 CORPORATE BODIES OF THE COMPANY
3.2 SHAREHOLDERS' MEETING

[70] *Kallrath*, Notar 2014, 75 (77).
[71] *Kallrath*, Notar 2014, 75 (78).
[72] Wording based on: *Kallrath*, Notar 2014, 75 (78).

3.3 SUPERVISORY BOARD

3.4 MANAGING DIRECTORS

3.4.1 Appointment/Removal. The Company shall have three (3) Managing Directors (*Geschäftsführer*) who shall be appointed (*bestellt*) and removed (*abberufen*) by the Shareholders' Meeting with simple majority (50% plus one vote) of the votes cast.

3.4.2 Power of Representation. [*intentionally left blank*]

3.4.3 Voting. [*intentionally left blank*]

3.4.4 Quorum. [*intentionally left blank*]

3.4.5 General Competencies. The Managing Directors manage the Company on its own responsibility. The Managing Directors are not bound by any instructions of the Partners. The Shareholders' Meeting is only responsible for monitoring the Managing Directors.

b) Composition of the Management

If the management consists of an odd number of members whereby, at least, one of the managing director is a third party or was mutually appointed by the partners and the resolutions are passed with simple majority, any matter in dispute can be decided by a majority vote on the management level of a joint venture company and deadlock situations can be prevented – ***Composition of the Management***.

Please refer to the following example of a clause which provides a management board consisting of three members whereby one member has to be proposed by the managing directors to be appointed by the joint venture partners:

EXAMPLE CLAUSE: COMPOSITION OF THE MANAGEMENT

3 CORPORATE GOVERNANCE

3.1 CORPORATE BODIES OF THE COMPANY

3.2 SHAREHOLDERS' MEETING

3.3 SUPERVISORY BOARD

3.4 MANAGING DIRECTORS

3.4.1 Appointment. The Company shall have three (3) Managing Directors (*Geschäftsführer*) and the Partners shall use their voting rights as shareholders of the Company, to the extent legally permissible, to ensure that the positions of such Managing Directors shall be appointed (*bestellt*) by the Shareholders' Meeting accordingly as follows:

(a) one (1) Managing Director to be appointed (*bestellt*) without undue delay (*unverzüglich*) upon proposal by X-GmbH;

(b) one (1) Managing Director to be appointed (*bestellt*) without undue delay (*unverzüglich*) upon proposal by Y-(Pty) Ltd; and

(c) one (1) Managing Director to be appointed (*bestellt*) without undue delay (*unverzüglich*) upon proposal by both Advisory Board Members to be appointed in accordance with subparagraphs (a) and (b).

3.4.2 Power of Representation. [*intentionally left blank*]

3.4.3 Removal. Each Partner shall be entitled to request at any time the removal and replacement of the respective appointed representative as Managing Director in accordance with Section 3.4.1(a) or Section 3.4.1(b) (as applicable) and the other Partner shall upon such request vote in favour of the removal of such person as Managing Director. The Managing Director appointed in accordance with Section 3.4.1(c) may be removed and replaced by shareholders' resolution adopted with a majority of at least three quarters of the votes cast.

3.4.4 Voting. Each Managing Director shall have one vote. Resolutions of the Managing Directors as a board are passed with simple majority of the votes cast.

3.4.5 Quorum. [*intentionally left blank*]

c) "Two to Hire, One to Fire" Principle

Finally, it could be suitable for the prevention of deadlocks on the management level of a joint venture company that the managing directors shall be appointed by both partners jointly but that each of them individually has the right to dismiss an appointed managing director – ***"Two to Hire, One to Fire" Principle***.[73]

For the decisions regarding the ongoing operating business of the company to be made by the company's managing directors, this principle is a compromise between the principle of unanimity, and the principle of majority rule, including, for example, by exercising a granted casting vote (as discussed in Section D.V.5).[74]

The aim of this principle is to ensure that the joint venture partners' interests are taken into account in the daily operational decisions whereby a partner is only be able to intervene in the future decision-making process by replacing a managing director who did not act in accordance with the relevant partner's interests in the past. Appointed by the partners jointly, the members of the management will usually consider the possi-

[73] MüHaGesR I/*Wirbel*, § 28 para. 59.
[74] MüHaGesR I/*Wirbel*, § 28 para. 59.

bility that each partner can remove them, so that they are incentivised to bear the interests of all joint venture partners in mind and to find a fair balance between such interests in the decision-making process.

In certain circumstances, this principle might be a solution if the joint venture partners are not able to find appropriate candidates for the position as managing directors who are neutral and enjoy the confidence of all partners.

Please refer to the following example of a clause which regulates the "two to hire, one to fire" principle:

EXAMPLE CLAUSE: "TWO TO HIRE, ONE TO FIRE" PRINCIPLE

3 CORPORATE GOVERNANCE

3.1 CORPORATE BODIES OF THE COMPANY

3.2 SHAREHOLDERS' MEETING

3.3 SUPERVISORY BOARD

3.4 MANAGING DIRECTORS

3.4.1 Appointment. The Company shall have three (3) Managing Directors, which shall be selected by both Partners mutually. The Partners shall use their voting rights as shareholders of the Company, to the extent legally permissible, to ensure that the positions of such Managing Directors shall be appointed (*bestellt*) by the Shareholders' Meeting.

3.4.2 Power of Representation. [*intentionally left blank*]

3.4.3 Removal. Each Partner shall be entitled to request at any time the removal and replacement of a Managing Director and the other Partner shall upon such request vote in favour of the removal of such person as Managing Director.

3.4.4 Voting. Each Managing Director shall have one vote. Resolutions of the Managing Directors as a board are passed with simple majority of the votes cast.

3.4.5 Quorum. [*intentionally left blank*]

VI. Exit Mechanisms

Apart from preservation mechanisms, as described in Section D.V, there are several mechanisms which can be included in joint venture agreements in order to resolve a deadlock between or among joint venture partners pursuant to which, at least, one partner has to leave the joint venture company as shareholder and thus it maybe results in the end of the joint venture – ***Exit Mechanisms***.

Firstly, there are the so-called "traditional mechanisms" which are not specifically related to joint ventures, but can regularly be found in joint venture agreements, shareholders' agreements and other business agreements in order to terminate a business cooperation. An overview of these common mechanisms is given in Subsection D.VI.1.

Further, there is a so-called "multi-choice approach", as explained in Subsection D.VI.2, pursuant to which the joint venture partners can choose between certain of the aforementioned traditional mechanisms.

As another way to resolve a deadlock, option rights can be granted, so that a partner has the right to buy the other partner's interest in the joint venture company (call option) and/or the right to sell its own interest to the other partner (put option) in the event of a deadlock.

And finally, the joint venture partners can agree on different variations of buy-sell mechanisms commonly known as "shoot-out" clauses. These different mechanisms analysed in detail in Subsection D.VI.4.

These exit mechanisms are not necessarily linked to, and do not necessarily need, the occurrence of a deadlock, rather they can also be granted to each joint venture partner as a right to leave the joint venture company regardless of any dispute between them (*e.g.*, in the event of a breach or as a termination right).[75]

1. Traditional Mechanisms

As explained above, the mechanisms to terminate the joint cooperation discussed in this Subsection D.VI.1 are not specifically related to joint venture agreements. Since the main focus of this dissertation is on buy-sell mechanisms discussed in Subsection D.VI.4, only a selection of common exit mechanisms are explained briefly in the following without providing respective examples of clauses.

a) Termination Rights

According to German law, there is no statutory right of ordinary termination (*Recht zur ordentlichen Kündigung*) in a corporation pursuant to German law, so that a joint

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[75] *Hohmuth*, ZIP 2016, 658 (661).

venture partner as shareholder of a joint venture company, for instance, in the form of a German liability company (*Gesellschaft mit beschränkter Haftung – GmbH*) requires a good cause (*wichtiger Grund*) to withdraw from it. However, the partners can include a right of ordinary termination (*Recht zur ordentlichen Kündigung*) and can regulate the legal consequences of termination in the company's articles of association.[76]

Further, it should be considered to explicitly include a right to withdraw in case of a good cause (*Recht zum Austritt aus wichtigem Grund*) including a non-comprehensive catalogue of specific causes, in particular, an irreconcilable dispute between the joint venture partners.

b) Forced Sale of the Joint Venture Company

A deadlock situation between joint venture partners can also be resolved by way of a sale of one partner's interest in the joint venture company, or by way of a sale of the joint venture company at whole, to a third party.[77]

Usually, a joint venture partner is not allowed to sell its interest in the joint venture company to a third party without the consent of the other joint venture partners and/or the company (limitation of transferability (*Vinkulierung*)). In order to allow such a sale to a third party in a deadlock situation, the joint venture agreement and/or the articles of association of the company can provide that, at least, one of the partners has the right to sell its interest in the company to a third party in such an event. This would allow the venture to continue, but finding a suitable third party to enter the joint cooperation may prove difficult.

In order to enable, or to facilitate, a sale of an equity interest in the company to a third party, a drag-along right can be granted to the joint venture partners which are allowed to sell their shares. A drag-along right grants a shareholder, in the event of a sale of its shares in a company, a right to force the other shareholders to sell their shares and, therefore, to join the sale of the entire company, if the third party is willing to acquire all company shares.[78]

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[76] For more information: *Kallrath*, Notar 2014, 75 (82).
[77] *Holler/Frese*, BB 2014, 1479 (1480).
[78] Schulte/Schwindt/Kuhn/*Kuhn*, § 8 para. 115 *et seqq.*; *Schulte/Pohl*, para. 765; *Fleischer/Schneider*, DB 2012, 961 (962).

In such a situation the other partners require usually the right of first offer (ROFO), or the right of first refusal (ROFR), to ensure that they have the right to buy out the other partner (proportionally), and do not need to continue the venture cooperating with a new, unknown partner.

For the case that the other partners are not interested in continuing the venture without the selling partner, and the selling partner has not exercised its drag-along right, a tag-along right can be granted in favour of the other partners. A tag-along right grants a shareholder, in the event of a sale of shares in a company by the other shareholder(s), a right to sell its shares and, therefore, to join the sale of the company to the third party on the same conditions as agreed between the other shareholder(s) and the third party.[79]

The joint venture agreement can further provide regulations, *inter alia*, regarding the sale process (*e.g.*, proprietary sale, auction, or initial public offering (IPO)), the engagement of transaction advisors, the control of the sale process, a specific minimum price and the consequences if such determined minimum price will not be achieved, as well as the provision of any fall-back procedure, etc.).

c) De-merger of the Joint Venture Company

An indissoluble dispute between the joint venture partners in an equity joint venture can theoretically also be resolved by way of a de-merger (*Spaltung*) of the joint company. But such a measure can actually only be used by the partners consensually at the time a deadlock has been occurred, since it is likely that the partners do not intend, or are not be in a position, to allocate the assets of the joint venture (which will be generated in the future) at the beginning of the joint cooperation.

d) Winding-up of the Joint Venture Company

In addition to the statutory rights of winding-up of the joint venture company pursuant to applicable law, the joint venture partners may, as the *ultima ratio* solution, agree upon that a deadlock between them shall be deemed as a reason giving each of them the right to demand the winding-up of the company.

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[79] Schulte/Schwindt/Kuhn/*Kuhn*, § 8 para. 114; *Schulte/Pohl*, para. 763 *et seq*.; *Fleischer/Schneider*, DB 2012, 961 (962).

Winding-up of the joint venture company is the most straight-forwarded but, on the other hand, probably the adverse option to solve a deadlock. It is likely that the partners will receive higher proceeds from a disposal of the joint venture company as a going concern than in case of its winding-up.[80] The right to demand the winding-up of the joint venture company acts, therefore, also as an incentive for the partners to find a mutual solution.

However, the key advantage of this exit mechanism is that it enables the partners to end the joint cooperation in a clearly structured formal process pursuant to statutory provisions.

2. Multi-Choice Procedure

Beside the "traditional mechanisms" as explained above, the joint venture agreement can provide a mechanism pursuant to which the partners shall co-operate in order to resolve a deadlock, in particular by means of methods in which, at least, one partner leaves the joint venture company, *e.g.*, (i) the sale of its interest in the company to the company, another joint venture partner or a third party; (ii) the sale of the whole company to a third party; (iii) the de-merger of the company; or (iv) the *de facto* splitting of the company – ***a Multi-Choice Procedure***.

As a fall-back procedure, the joint venture agreement can provide that either partner should have the right to require the company to be wound up, if they cannot agree on one of the described methods or cannot otherwise resolve the matter in dispute by mutual agreement.[81]

Please refer to the following example of a clause pursuant to which the joint venture partners shall negotiate over a certain period of time, trying to resolve the deadlock by taking into account the listed procedures, before either partner has the right to demand the winding-up of the company:

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[80] *Hewitt*, p. 247.
[81] *Hewitt*, p. 252 *et seq.*

EXAMPLE CLAUSE: MULTI-CHOICE PROCEDURE[82]

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.2 [PRESERVATION MECHANISMS]

6.3 DEADLOCK RESOLUTION

6.3.1 Deadlock Resolution Notice. A "**Deadlock Resolution Notice**" is a written notice served by one Partner on the other in which the server informs the other Partner about its intention to formally resolve the Deadlock within [ninety (90)] calendar days. The Partners shall continue to negotiate in good faith with a view to resolving the matter in dispute including by one of the following methods:

(a) the purchase by the Company of the initiating Partner's shares in the Company on terms acceptable to the Partners (provided that the purchase by the Company can lawfully be made and is financially practicable);

(b) the purchase by the other Partner of the initiating Partner's shares in the Company (or the sale of that Partner's shares to one or more third parties);

(c) the de-merger of the Company; or

(d) the sale of the whole of the issued share capital of the Company to a third party.

6.3.2 Winding-up Notice. If no such method of resolution has been agreed or the Partners have not resolved the Deadlock otherwise by any other written mutually acceptable agreement within [ninety (90)] calendar days after service of the Deadlock Resolution Notice, either of the Partners may serve notice to the other Partner requiring the Company to be wound-up (a "**Winding-up Notice**"). [No Winding-up Notice may, however, be served by either Partner within the initial [five (5)] years after the establishment of the Company].

6.3.3 Winding-up. Upon or as soon as practicable after the Winding-up Notice under Section 6.3.2, the Partners shall use their respective powers and votes to cause the Company to be placed in liquidation. The Partners shall co-operate to ensure that all existing contracts entered into by the Company (or any subsidiary thereof) prior to such winding-up shall be duly completed subject to such arrangements as the Partners may mutually agree. The Partners shall endeavour to agree upon an appropriate allocation of the assets of the Company prior to any such winding-up.

3. Option Rights

Deadlocks can also be solved by means of exercising granted share transfer options. There are two different types of share transfer options which can be granted to a shareholder of a company for the case that a determined event will be triggered: (i) the right to buy the company shares of the other shareholder(s) – ***a Call Option***; or (ii) the right

to sell its company shares to the other shareholder(s) – ***a Put Option***. Beside the option to determine any breach of the joint venture agreement by one of the partners as a trigger event for such option rights, the occurrence of a deadlock between the partners could also give the right to exercise the option right(s).[83]

The advantage of granting option rights is that, at least, one of the joint venture partners withdrawals as a shareholder from the joint venture company if such a right will be exercised, and thus the existing dispute between the partners will be dissolved. However, the major disadvantage is that the conditions for the share transfer must already be determined by the partners when granting the respective option, *e.g.*, provision of representations and warranties by the selling partner, transfer of any IP rights and know-how, regulation of any non-compete obligations, dealing with any financing (in particular shareholder loans), requirement of any regulatory approval (in particular merger control), allocation of costs, etc.[84] The determination of the share transfer price can be made by an independent third party (expert) when the relevant option right has been exercised or the joint venture partners agree on a specific calculation formula in the joint venture agreement.[85]

Since the common form of option rights favours one partner over the other(s), such provisions are frequently used in majority/minority joint ventures where the call option is usually granted to the majority shareholder of the joint venture company to ensure that it has the right to buy out the minority shareholder for the case that the minority shareholder exercises a given veto right or otherwise boycotts the decision making process in a company body.[86] The minority shareholder might be granted in return a put option giving the right to sell its interest to the majority shareholder in the event of a deadlock.[87]

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[82] Wording based on: International Trade Centre, August 2010, Model Contracts for Small Firms: International Corporate Joint Venture (available at: *http://www.intracen.org/uploadedFiles/intracenorg/Content/Exporters/Exporting_Better/Templates_of_contracts/2%20International%20Corporate%20Joint%20Venture.pdf)*, accessed on 18 February 2018; *Hewitt*, p. 761 *et seq*.

[83] *De Ly*, IBLJ 1995, 3, 279 (299).

[84] *Schulte/Sieger*, NZG 2005, 24 (26).

[85] *Robles y Zepf/Girnth/Stumm*, BB 2016, 2947 (2949).

[86] *Hewitt*, p. 247.

[87] *De Ly*, IBLJ 1995, 3, 279 (301).

However, it is also conceivable that call-/put options are used in joint ventures where the partners are (almost) equally participated in the joint venture company. But this requires that the joint venture partners are able to agree on the holder of the relevant option. If the partners are not able to come to an agreement who should be the beneficiary, *i.e.*, which partner will have the choice, in the event of a deadlock as trigger event, to stay in or leave the company, other solutions should be sought such as: (i) the partner causing the deadlock shall grant a call option and/or a put option to the other partner, which for logically reasons requires that the definition of a deadlock must be so specific that this partner can be identified without ambiguity (*e.g.*, boycott of meetings) – otherwise it is highly likely that answering this question will end up in litigation (please refer to the following example of a clause); or (ii) the partners agree on mutual option clauses such as shoot-out / buy-sell mechanisms where both partners have the right to exercise the relevant mechanism (as explained in detail under Subsection D.VI.4 below).[88]

EXAMPLE CLAUSE: CALL-/PUT OPTIONS[89]

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.2 PRESERVATION MECHANISM

6.3 CALL-/PUT OPTIONS

6.3.1 Deadlock Resolution Notice. A "**Deadlock Resolution Notice**" is a written notice served by the Non-Defaulting Partner on the Defaulting Partner in which the server exercises a granted option right pursuant to Section 6.3.3 [or Section 6.3.4] and in accordance with the provisions therein. For the purpose of this Section 6.3, "**Non-Defaulting Partner**" shall mean the Partner which has wilfully (*vorsätzlich*) or negligently (*fahrlässig*) caused the Deadlock, and "**Defaulting Partner**" shall mean the Partner which is not the Non-Defaulting Partner.

6.3.2 No Revocation and Lock-up Period. A Deadlock Resolution Notice:

(a) may not be revoked; and

(b) [may not be served before the [first] anniversary of the date of this Agreement].

6.3.3 Call Option. The Non-Defaulting Partner shall be entitled (but not obliged) to purchase and acquire, or to designate a third party which the Non-Default-

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88 *De Ly*, IBLJ 1995, 3, 279 (301).

89 Wording based on: *Hewitt*, p. 721 *et seqq*.

ing Partner shall cause (*steht dafür ein*) to purchase and acquire, and the Defaulting Partner hereby irrevocably offers to sell and transfer to the Non-Defaulting Partner, or to a third party designated by the Non-Defaulting Partner, all shares then held by the Defaulting Partner in the Company (the "**Call Option**").

6.3.4 [Put Option. The Non-Defaulting Partner shall be entitled (but not obliged) to sell and transfer to the Defaulting Partner, and the Defaulting Partner hereby irrevocably offers to purchase and acquire, or to a third party designated by the Defaulting Partner which the Defaulting Partner shall cause (*steht dafür ein*) to purchase and acquire, all shares then held by the Non-Defaulting Partner in the Company (the "**Put Option**", and together with the Call Option, the "**Options**").]

6.3.5 Strike Window. [The Call Option | Each of the Options] can only be exercised from the date of receipt *(Zugang)* of the Deadlock Notice until no later than [twelve (12)] months after this date (the first day being the day after the day of receipt) (the "**Strike Window**"). Upon lapse of the Strike Window, [the Call Option | the Options] forfeit[s] and cease[s] to be exercisable.

6.3.6 Strike Price. [MECHANISM TO BE INCLUDED ON WHICH BASIS THE PURCHASE PRICE SHALL BE DETERMINED, E.G., VALUATION METHOD, THIRD PARTY EXPERT, (DAY OR NIGHT) ARBITRATION ETC.].

6.3.7 Completion. On receipt of the Deadlock Resolution Notice during the Strike Window, the Partners shall be bound to sell and transfer, and to purchase and receive, (as the case may be) its shares in the Company for the Strike Price on the terms set out in Section [*COMPLETION OF THE SALE AND PURCHASE OF SHARES IN THE COMPANY*] of this Agreement.

4. Shoot-Out / Buy-Sell Mechanisms

A specific type of provisions which can regularly be found in joint venture agreements does not favour one joint venture partner over the other(s), rather it allows each of them to trigger a mechanism which in any event results in the buy-out of, at least, one, but uncertain which, of the joint venture partner – ***Shoot-Out*** or ***Buy-Sell Mechanisms***.[90]

These clauses are similar to call-/put options (as explained in Section D.VI.3) in terms of their procedure and their effect, since the joint venture partners are also bound to sell and transfer, and to purchase and receive, (as the case may be) the relevant interest in the joint venture company as the result of such a mechanism. But, from a legal point

[90] *Fleischer/Schneider*, DB 2010, 2713 (2713).

of view, the rights granted under shoot-out clauses are not option rights (call-/put options), since the exercising partner did not have the right to conclude a share purchase or share sale by an unilateral declaration *vis-à-vis* the other partner(s).[91] On the contrary, when exercising the right given under the shoot-out clause, the partner does not know whether it will be obliged to buy the other partner's shares in the company or to sell its own shares in the company to the other partner.[92]

Besides answering the question who has to transfer its shares to the other partner, these mechanisms provide a solution how the share transfer price can be determined.

In the following Subsections a) to e), different basic forms and variations of such mechanisms are explained, several drafting possibilities are described, and their advantages and disadvantages are discussed.

a) Russian Roulette[93]

"Russian Roulette: The practice of loading a bullet into one chamber of a revolver, spinning the cylinder, and then pulling the trigger while pointing the gun at one's own head."[94]

This prominent "game" has given a type of buy-sell arrangements its name due to the unpredictability of the procedure's outcome, in particular for the party who has initiated it. The classic (plain vanilla) version of such mechanism to resolve a deadlock between joint venture partners can be described as follows:

Once a deadlock has been occurred and preservation mechanisms, if any, could not resolve it, either partner has the right to send an offer to the other partner stating the price at which it is willing to sell and transfer all of its shares in the joint venture company. The receiving partner has the options (i) to accept such offer and to buy and receive all shares from the offering partner to the specified conditions; or (ii) to reject

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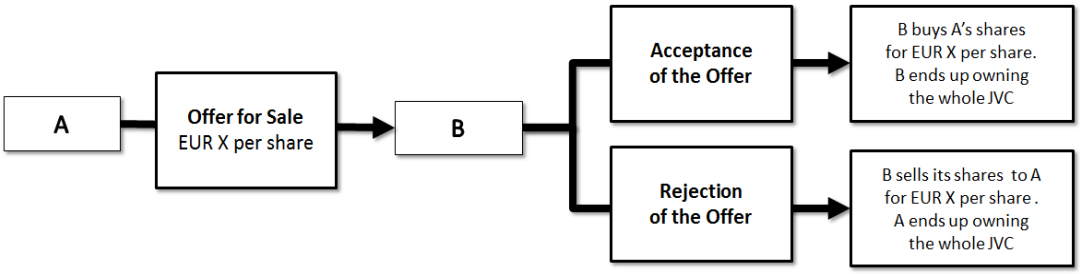
91 *Robles y Zepf/Girnth/Stumm*, BB 2016, 2947 (2951).
92 *Robles y Zepf/Girnth/Stumm*, BB 2016, 2947 (2951).
93 Also known as: "*Shotgun*".
94 Oxford Dictionaries, available at: *https://en.oxforddictionaries.com/definition/Russian_roulette*, accessed on 18 February 2018.

the offer and to be obliged to sell and transfer its own shares at the specified (proportionate) conditions to the partner which initially wants to sell its shares – commonly known as ***Russian Roulette***.

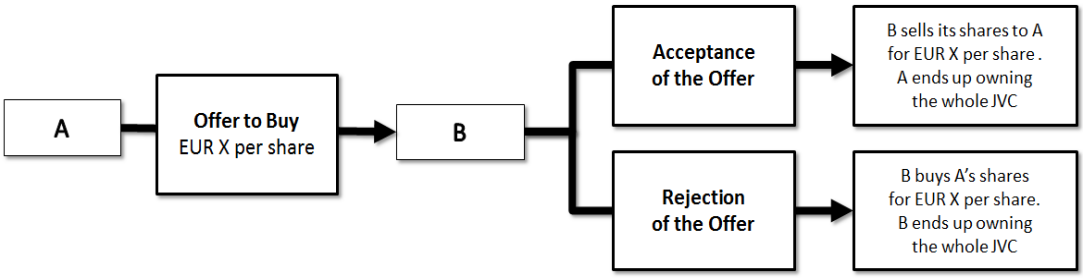
In short, it follows the principle: Buy my shares or sell me your shares to the conditions specified in my sale offer.[95]

Russian Roulette[96]
(Offer for Sale)



Besides this structure pursuant to which one partner has to send an offer for sale to the other partner, the clause can also be drafted in a way that the initiating partner has the choice to send an offer for sale or an offer to buy. The mechanism applies accordingly. The only difference between these different forms is that the receiving partner can normally perceive the intention of the other partner to sell or to buy the business if both options are granted.

Russian Roulette[97]
(Offer to Buy)



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95 *Robles y Zepf/Girnth/Stumm*, BB 2016, 2947 (2949).

96 Illustration based on: Thomson Reuters, Practical Law Corporate (Australia), Note: "T*ermination: joint ventures*", available at: https://au.practicallaw.thomsonreuters.com/Document/Ib555201be83211e398db8b09b4f043e0/View/FullText.html?originationContext=docHeader&contextData=(sc.DocLink)&transitionType=Document&needToInjectTerms=False&firstPage=true&bhcp=1, accessed on 18 February 2018.

97 Please refer to fn. 96.

By inclusion of this relatively simple Russian Roulette mechanism, it can be ensured that a partner of the joint venture is obliged to rapidly leave the joint venture company as shareholder, resolving the deadlock between the joint venture partners.[98] Long negotiations between the disagreeing partners how to dissolve the joint venture company can be avoided. Since each of the partners has the right to trigger the mechanism, it can be described as fair, providing the same chance for each partner to end up owning the whole company. The lack of foreseeability of the outcome of the process can be understood as a disadvantage, but on the other hand it may increase the partners' willingness to reach an agreement in the event of a deadlock.

By determination of the share purchase price by the offering partner, the approach follows the "I cut, you choose" logic.[99] This approach ensures that the share purchase price set out in the initial offer is reasonable and is not only favourable for the offering partner. The offering partner determines the price for the company and "cuts the cake", while the other partner "picks the piece of cake" and decides whether to buy or sell its ownership in the joint venture company.[100] In other words, when the partner serves the deadlock resolution notice including its offer it does not know whether it will buy or sell the respective interest in the company so that it is incentivized to specify a reasonable price.

This logic will only result in a reasonable price determination if no partner has knowledge about any restrictions or other circumstances which hinder one partner to buy the other partner's interest, such as (i) restraints on foreign ownership in the country of the joint venture company; (ii) adverse tax consequences for the potential acquirer; (iii) dependence of the joint venture company's business on one partner's knowledge, know-how, or other relationships; or (iv) incapability of financing the purchase price by one partner.[101] Should any of these restrictions or circumstances to the detriment of a partner exists, there is a risk that the other partner could exploit its stronger position by causing a deadlock situation and initiating the exit mechanism.

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98 *Duve*, AnwBl 2007, 389 (391); MüHaGesR/*Baumanns/Wirbel*, para. 62.
99 *Fleischer/Schneider*, DB 2010, 2713 (2714).
100 *Ibid*, fn. 99.
101 *Hewitt*, p. 248 *et seq*.

In particular in case of the last example (*i.e.*, by making an offer below market value knowing that the receiving partner does not have the financial resources to purchase the initiating partner's interest, the initiating partner can force the other partner to sell its interest in the joint venture company to an under market value), the terms and conditions of the Russian Roulette mechanism can be adapted to prevent, or delay, that the financially stronger partner takes advantage of the procedure.

To protect a joint venture partner from being forced to accept an unfair offer, the following questions should, *inter alia*, be addressed when drafting the Russian Roulette provision:

(i) *How long shall the receiving partner have to respond?*

The shorter the period of time until the partner must respond to the initial offer, the more difficult it is for the receiving partner to ensure the required financing. But also as a general comment, it is recommended to grant a sufficient time period in order to enable the receiving partner to assess the offered price, to find out the business opportunities in the market, and to answer other relevant commercial questions before the decision must be made whether to buy the joint venture company or not.

(ii) *Shall either partner have the right to assign its rights or bring in financial partners?*

In case the receiving partner cannot afford to buy out the initiating partner, the Russian Roulette provision could stipulate that the receiving partner has the right to assign its rights under the joint venture agreement or to team up with third parties so that the demanded share price could be provided by a new investor or the new established group of investors.[102]

(iii) *How long shall the receiving partner have to close the purchase if it decides to buy out the initiating partner, in particular how and when must the purchase price be paid?*

This question also relates to the period of time necessary to get the required deal financing. For the case that the receiving partner has to cope with liquidity issues, a provision can be included in the joint venture agreement that the purchase price may

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[102] *Otto*, GmbHR 1996, 16 (20); *Fleischer/Schneider*, DB 2010, 2713 (2718).

be paid in instalments over a specific period of time (if the purchase price exceeds a certain threshold).[103]

(iv) *Are there any modifications of the Russian Roulette mechanism regarding the determination of the purchase price?*

To protect a partner from being forced to accept an unfair offer, it can be stipulated that the share purchase price has to be determined through a specific valuation procedure (the initiating partner bearing the costs for the valuation) and the offer price has to be no less than a certain percentage of that valuation. By including such a valuation procedure, the partners can ensure that the shares will be transferred from one partner to the other to a "true"/"fair" market value.

Further, it should also be considered to determine a minimum period after the establishment of the joint venture company in which the joint venture partner are not allowed to trigger the exit mechanism. Such a lock-up period can ensure that they can rely on the existence of the joint cooperation for the specific time period, providing them with greater confidence when investing in the joint venture company and taking other commercial decisions.[104] Furthermore, it protects joint venture partner against others who wants to use the joint venture only to get access to know-how, expertise and other knowledge.

In order to ensure that the Russian Roulette mechanism will definitively resolve the deadlock situation it is necessary that the clause provides a regulation for the case that the recipient of the offer will not reply, for example, that in such a case the offer shall be deemed as accepted by the receiving partner. This effect can further be enhanced in a way that the share purchase price will be increased (initial offer for sale) or decreased (initial offer to buy) in favour of the initiating partner, if the receiving partner does not respond.[105]

In case the Russian Roulette mechanism does not be triggered by way of sending a deadlock resolution notice from one partner to the other partner within the relevant

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[103] *Otto*, GmbHR 1996, 16 (20); *Fleischer/Schneider*, DB 2010, 2713 (2718).
[104] *Otto*, GmbHR 1996, 16 (20); *Fleischer/Schneider*, DB 2010, 2713 (2718).
[105] *Fleischer/Schneider*, DB 2010, 2713 (2714); *Schulte/Sieger*, NZG 2005, 24 (26).

time period, it depends on the provisions included in the joint venture agreement which consequence follows, for example:

(i) either partner could may have the right to demand the liquidation of the joint venture company so that either of them has the choice to trigger the Russian Roulette mechanism in the agreed time period, or to demand the liquidation of the company after expiry of the respective time period;

(ii) the liquidation could be triggered automatically after expiry of the respective time period so that the partners are obliged to take the necessary steps in order to liquidate the company;

(iii) the partners can be obliged to sell the joint venture company conjointly; or

(iv) the agreement could be silent so that the deadlock will not be resolved and the joint venture partner must come to an agreement to continue or to end their business relationship, which would neglect the main goal of the Russian Roulette, *i.e.*, to ensure that the deadlock will be resolved.

As with option rights, one disadvantage is that the conditions for the share transfer must already be determined, and, therefore, the specific circumstances in the future must be anticipated, by the partners when entering into the joint venture agreement.[106] The conditions are usually set out in a separate clause of the joint venture agreement including, *inter alia*, the provision of the duty to cooperate to transfer the ownership of the relevant interest in the company, and a catalogue of substantial representations and warranties by the selling partner (reference is made to the catalogue of conditions stated in Section D.VI.3).

Please refer to the following example of a clause which provides a Russian Roulette mechanism:

EXAMPLE CLAUSE: RUSSIAN ROULETTE[107]

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

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[106] *Schulte/Sieger*, NZG 2005, 24 (26).

[107] Wording based on: Lawdit Solicitors, Joint Venture Shareholders' Agreement, available at: *https://www.lawdit.co.uk/uploads/documents/Joint%20Venture%20Agreement.pdf*, accessed on 18 February 2018.

6.2 MEDIATION

6.3 DEADLOCK RESOLUTION

6.3.1 Deadlock Resolution Notice. A "**Deadlock Resolution Notice**" is a written notice served by one Partner on the other in which the server offers, at the price for each share specified in the notice (in cash and not on deferred terms), either to sell all its shares in the Company to the recipient of the notice or to buy all the recipient's shares in the Company.

6.3.2 No Revocation [and Lock-up Period]. A Deadlock Resolution Notice:

(a) may not be revoked; and

(b) [may not be served before the [first] anniversary of the date of this Agreement].

6.3.3 Counter-notice. The recipient of a Deadlock Resolution Notice may choose to do either of the following, at the price for each share specified in the Deadlock Resolution Notice, by serving a counter-notice within [twenty-eight (28)] calendar days of receiving the Deadlock Resolution Notice (the first day is the day after the day of receipt):

(a) buy all the shares in the Company of the server of the Deadlock Resolution Notice; or

(b) sell all its shares in the Company to the server of the Deadlock Resolution Notice.

6.3.4 No Counter-notice. If no counter-notice is served within the period of [twenty-eight (28)] calendar days available, the recipient of the Deadlock Resolution Notice is deemed to have accepted the offer in the Deadlock Resolution Notice at the expiry of that period.

6.3.5 Completion. If the recipient of the Deadlock Resolution Notice serves a counter-notice in accordance with Section 6.3.3, or is deemed to have accepted the offer pursuant to Section 6.3.4, then the Partners shall be bound to buy and sell the shares (as the case may be) at the (proportional) price set out in the Deadlock Resolution Notice and on the terms set out in Section [*COMPLETION OF THE SALE AND PURCHASE OF SHARES IN THE COMPANY*].

6.3.6 Several Deadlock Resolution Notices. If both Partners serve a Deadlock Resolution Notice pursuant to Section 6.3.1, [the first Deadlock Resolution Notice served | the Deadlock Resolution Notice containing the highest price per share] shall be effective.

6.3.7 [No Deadlock Resolution Notice. [If at the end of the [twenty-eight (28)] calendar day period specified in Section [*RELEVANT PRESERVATION MECHANISM*], neither Partner has served a Deadlock Resolution Notice, [either Partner may elect by written notice served on the other Partner and the Company requiring that [the Company shall be wound up in accordance with Section [*WOUND UP PROCEDURE*] of this Agreement | the Company shall be wound up immediately | the Partners shall immediately proceed to sell conjointly their shares in the Company].]

6.3.8	References. References in this Section 6.3 to shares held by a Partner in the Company are to all the shares in the Company held by that Partner and not to some only of those shares.

A slightly modified version of the Russian Roulette mechanism requires that the initiating partner directly submits two offers – an offer for sale and an offer to buy – to the other partner and the other partner has to accept one of these offers.[108] Such modified version enables the initiating partner to emphasize its intention to buy, or sell, the other partner's stake in the joint venture company by increasing, or reducing, the offered purchase price – if the offered purchase price is above market value, the receiving partner would be more incentivised to sell its stake, whereas it would be more incentivised to buy the initiating partner's stake if the offered purchase price is below market value.

Since the Russian Roulette mechanism becomes complex in a multi-party joint venture due to its typical structure, an auction process can be included as a reasonable alternative (as explained in detail under Section D.VI.4.d) below).[109]

b) Texan Shoot-Out

Another variation of buy-sell arrangements grants, in the event of a deadlock, each partner the right to submit an offer stating the price at which it is willing to buy all of the other partner's shares in the joint venture company. The other partner has the options (i) to accept such offer and to sell its interest for the specified price; or (ii) to reject the offer and to submit a counteroffer to buy the original offering partner's interest in the joint venture company for a higher price. This process of offer and counteroffer can continue through several bidding rounds, with each bid required to exceed the previous bid, until one partner accepts the other partner's offer – commonly known as ***Texan Shoot-Out***.[110]

In short, it follows the principle: Sell me your shares or buy my shares for a higher price.[111]

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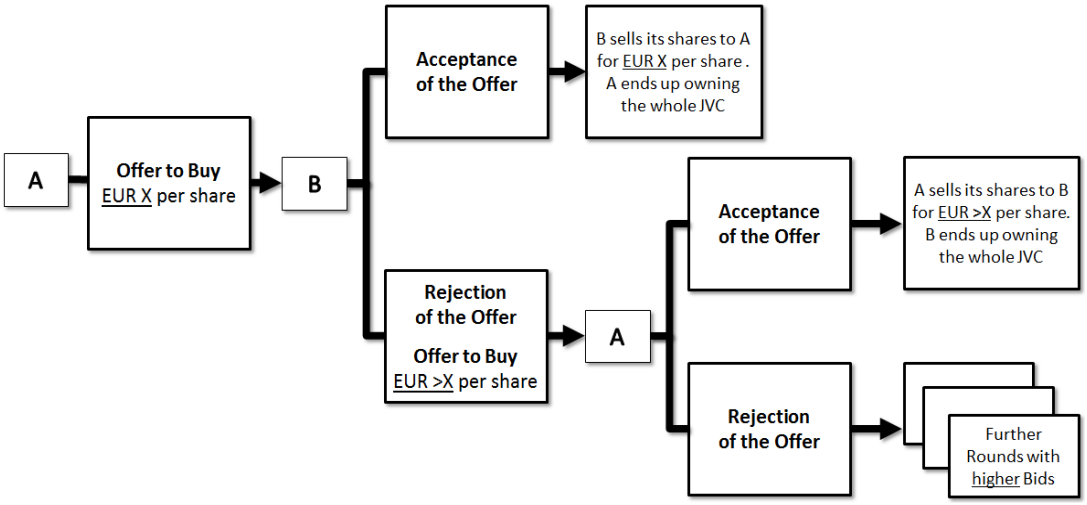
[108] *Willms/Bicker*, BB 2014, 1347 (1347).
[109] *Heckschen/Heidinger*, para. 191.
[110] *Fleischer/Schneider*, DB 2010, 2713 (2714); *Hohmuth*, ZIP 2016, 658 (661).
[111] *Robles y Zepf/Girnth/Stumm*, BB 2016, 2947 (2949).

Texan Shoot-Out[112]



This mechanism guarantees the greatest possible equality of opportunities for the joint venture partners.[113] By using a bidding procedure, it can be ensured that the finally accepted price per share is agreeable to both joint venture partners. Further, it makes certain that the joint venture partner purchases the company which is more interested in the company's business. This obviously requires that there is a level playing field for the joint venture partners, in particular that they have equal financial resources.[114] Thus, the same questions regarding any existing lack of financial capacity can be raised as discussed in relation to Russian Roulette clauses under Section D.VI.4.a) above.

In addition to the risk that the mechanism can be exploited to the detriment of the economically weaker partner, a further disadvantage is the risk that the initiating partner will probably start the bidding procedure with an extremely low offer in order to approach the limit of the other partner "bid-by-bid" so that the whole bidding procedure may take a long time, resulting in increased costs and a time period of uncertainty for the business of the company and all other parties involved.[115] To minimise or eliminate the risk of an excessive bidding procedure, the Texan Shoot-Out provision can be amended as follows:

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[112] Please refer to fn. 96.
[113] *Otto*, GmbHGR 1996, 16 (19).
[114] *Fett/Spiering*, chap. 7, para. 601.
[115] *Otto*, GmbHR 1996, 16 (19 *et seq.*).

(i) the clause can provide a limitation that each partner is only allowed to submit a certain number of increased offers;[116]

(ii) the clause can provide that each counteroffer has to be higher than each previous offer by a specified percentage;[117]

(iii) the clause can provide that the joint venture partners meet in person and enter into an auction process; and/or

(iv) the clause can provide that the parties, instead of using the bidding procedure, submit sealed bids to an independent third party. The partner which has submitted either (y) the highest sealed bid, *i.e.*, the bid stating the highest purchase price per share; or (z) the fairest sealed bid, *i.e.*, the bid stating the purchase price per share closest to the price determined by an appointed third party (expert) as being the fair value of the shares wins and has the right to purchase the other partner's interest in the company (as explained in detail under Section D.VI.4.d) below).[118]

Please refer to the following example of a clause which provides a Texan Shoot-Out mechanism:

EXAMPLE CLAUSE: TEXAN SHOOT-OUT[119]

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK MATTERS

6.2 [PRESERVATION MECHANISMS]

6.3 DEADLOCK RESOLUTION

6.3.1 Deadlock Resolution Notice. A "**Deadlock Resolution Notice**" is a notice served by one Partner on the other in which the server offers to buy all of the recipient's shares in the Company at the price (in cash and not on deferred terms) for each share specified in the notice which may be:

(a) positive and offer payment to the transferor of the shares; or

(b) negative and require payment to be made by the transferor of the shares.

6.3.2 No Revocation [and Lock-up Period]. A Deadlock Resolution Notice:

(a) may not be revoked; and

(b) [may not be served before the [first] anniversary of the date of this Agreement].

6.3.3 Counter-notice. The recipient of a Deadlock Resolution Notice may choose to do either of the following, by serving a counter-notice within [twenty-

[116] *Robles y Zepf/Girnth/Stumm*, BB 2016, 2947 (2949).
[117] *Fleischer/Schneider*, DB 2010, 2713 (2714).
[118] *Fleischer/Schneider*, DB 2010, 2713 (2714).
[119] Please refer to fn. 107.

eight (28)] calendar days of receiving the Deadlock Resolution Notice (the first day is the day after the day of receipt):

(a) sell all of its shares in the Company to the server of the Deadlock Resolution Notice at the price for each share specified in the Deadlock Resolution Notice; or

(b) confirm that it wishes to buy all of the shares of the server of the Deadlock Resolution Notice at a specified higher price for each share than the price specified in the Deadlock Resolution Notice. [This price needs to be at least [10]% (in words: [ten] per cent) higher than the price specified in the Deadlock Resolution Notice.]

6.3.4 No Counter-notice. If no counter-notice is served within the [twenty-eight (28)] calendar days available, the recipient of the Deadlock Resolution Notice is deemed to have accepted the offer in the Deadlock Resolution Notice at the expiry of that period.

6.3.5 Completion. If the recipient of the Deadlock Resolution Notice serves a counter-notice in accordance with Section 6.3.3(a), or is deemed to have accepted the offer under Section 6.3.4, then the Partners shall be bound to buy and sell the shares (as the case may be) on the terms set out in Section [*COMPLETION OF THE SALE AND PURCHASE OF SHARES IN THE COMPANY*].

6.3.6 Bidding Procedure. If the recipient of the Deadlock Resolution Notice serves a counter-notice in accordance with Section 6.3.3(b) then the bidding procedure shall continue between the Partners granting the recipient of the last counter-notice the right to serve a further counter-notice to the server of the last counter-notice alternately. Sections 6.3.3 to 6.3.5 and Section 6.3.7 shall apply accordingly.

For the avoidance of doubt, such a bidding procedure shall end if and when one of the Partner accepts the offer of the other Partner by serving a respective counter-notice in accordance with Section 6.3.3(a), or is deemed to have accepted its offer under Section 6.3.4.

6.3.7 Negative Offer Amount. For the purpose of Section 6.3.3(b), where the offer made by the server of the Deadlock Resolution Notice is of a negative amount requiring payment by the transferor of the shares, a higher price means either:

(a) a lower payment required of the transferor of the shares; or

(b) a positive amount to be paid by the server of the counter-notice, as the case may be.

6.3.8 Several Deadlock Resolution Notices. If both Partners serve a Deadlock Resolution Notice pursuant to Section 6.3.1 [the first Deadlock Resolution Notice served | the Deadlock Resolution Notice containing the highest price per share] shall be effective and the procedure under Section 6.3.3 shall apply.

6.3.9 [No Deadlock Resolution Notice. [If at the end of the [twenty-eight (28) calendar day] period specified in Section [*RELEVANT PRESERVATION MECHANISM*], neither Partner has served a Deadlock Resolution Notice,

either Partner may elect by written notice served on the other Partner and the Company requiring that [the Company shall be wound up in accordance with Section [*WOUND UP PROCEDURE*] of this Agreement | the Company shall be wound up immediately | the Partners shall immediately proceed to sell conjointly their shares in the Company].]

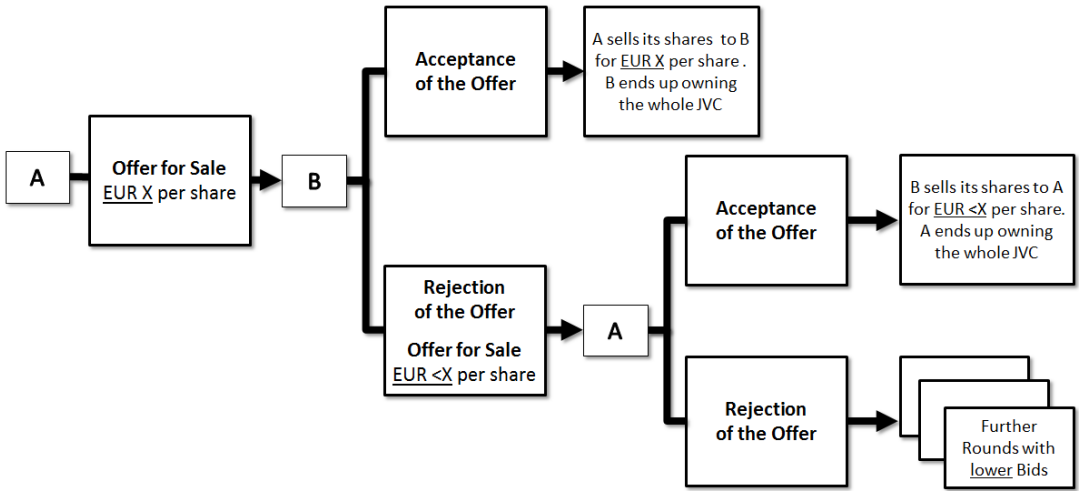
6.3.10 References. References in this Section 6.3 to shares held by a Partner in the Company are to all the shares in the Company held by that Partner and not to some only of those shares.

c) Sale Shoot-Out

The reserve variation of the Texan Shoot-Out grants, in the event of a deadlock, each partner the right to submit an offer stating the price at which it is willing to sell all of its own shares in the joint venture company. The other partner has the options (i) to accept such offer and to buy the offering partner's interest for the specified price; or (ii) to reject the offer and to submit a counteroffer to sell its interest in the joint venture company for a lower price. This process of offer and counteroffer can continue through several bidding rounds, with each bid required to decreed the previous bid, until one partner accepts the other partner's offer – commonly known as ***Sale Shoot-Out***.[120]

In short, it follows the principle: Buy my shares or sell me your shares for a lower price.

Sale Shoot-Out[121]



[120] *Fleischer/Schneider*, DB 2010, 2713 (2714).
[121] Please refer to fn. 96.

Please refer to the following example of a clause which provides a Sale Shoot-Out mechanism:

EXAMPLE CLAUSE: SALE SHOOT-OUT[122]

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK MATTERS

6.2 [PRESERVATION MECHANISMS]

6.3 DEADLOCK RESOLUTION

6.3.1 Deadlock Resolution Notice. A "**Deadlock Resolution Notice**" is a notice served by one Partner on the other in which the server offers to sell all of its shares in the Company at the price (in cash and not on deferred terms) for each share specified in the notice which may be:

(a) positive and require payment to the transferor of the shares; or

(b) negative and require payment to be made by the transferor of the shares.

6.3.2 No Revocation [and Lock-up Period]. [reference is made to the "Example Clause: Texan Shoot-Out" in the Section D.VI.4.b) above].

6.3.3 Counter-notice. The recipient of a Deadlock Resolution Notice may choose to do either of the following, by serving a counter-notice within [twenty-eight (28)] calendar days of receiving the Deadlock Resolution Notice (the first day is the day after the day of receipt):

(a) buy all the shares in the Company of the server of the Deadlock Resolution Notice at the price for each share specified in the Deadlock Resolution Notice; or

(b) confirm that it wishes to sell all its shares in the Company to the server of the Deadlock Resolution Notice at a specified lower price for each share than the price specified in the Deadlock Resolution Notice. [This price needs to be at least [10]% (in words: [ten] per cent) lower than the price specified in the Deadlock Resolution Notice.]

6.3.4 No Counter-notice. [regarding the following Subsections 6.3.4 to 6.3.10 reference is made to the "Example Clause: Texan Shoot-Out" in the Section D.VI.4.b) above].

It depends heavily on the specific circumstances, but it is more likely that the bidding process in case of the Texan Shoot-Out starts with an offer below market value and results, therefore, in an increased risk that a share price under market value will be accepted. While in case of the Sale Shoot-Out the situation is the opposite and it is

[122] Please refer to fn. 107.

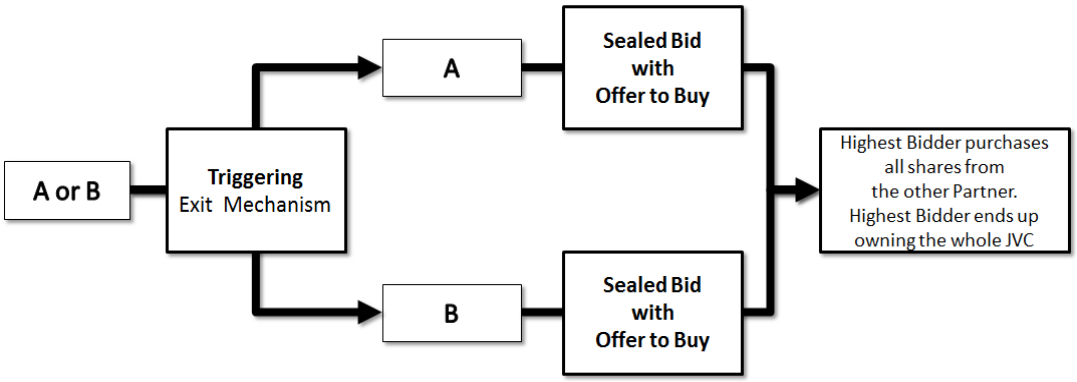
more likely that the bidding process starts with an offer above market value and results in an increased risk that a share price under market value will be accepted.

d) Mexican Shoot-Out[123]

Another variation of buy-sell arrangements provides, instead of a bidding procedure, that each partner may declare a deadlock initiating an auction process pursuant to which each partner has the right to submit to an independent third party (*e.g.*, an appointed notary) a sealed bid stating the price at which it is willing to buy out the other partner. The sealed bids are opened together and the independent third party determines the bid with the highest purchase price per share offered. The partner who submitted such bid "wins" the auction, and is then committed to buy the other partner's interest, and the losing bidder is committed to sell its interest, in the joint venture company for the relevant purchase price – commonly known as ***Mexican Shoot-Out***.[124]

In short, it follows the principle: ***The winner takes it all***.

Mexican Shoot-Out[125]



As an alternative that the bid with the highest purchase price per share wins, the joint venture partners can agree that the bid should be decisive which offers the purchase price per share closest to the price determined by an appointed independent third party (expert) as being the fair value of the shares or as the price based on the valuation

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[123] Also known as: "*Dutch Auction*" / "*Alternate Texan Shoot-Out*", and in the German literature also known as: "*sizilianische Eröffnung*" / "*Angebotshinterlegungsverfahren*".

[124] *Robles y Zepf/Girnth/Stumm*, BB 2016, 2947 (2950); *Otto*, GmbHGR 1996, 16 (19); *Willms/Bicker*, BB 2014, 1347 (1347).

[125] Please refer to fn. 96.

method provided for in the joint venture agreement, *i.e.*, the "fairest price".[126] This alternative could reduce the risk for a partner which is in a weaker financial position that its opposite could win the auction only due to its financial strength. In the variation that an independent third party (expert) should make the valuation of the joint venture company's business, the valuation can be made after or before the partners submit their bids. In case that the valuation is made before the submission (*i.e.*, unaware of such bids), the valuation of the third party might be more unbiased and not influenced by the other valuations received (commonly known as "(Day or Night) Baseball Arbitration").[127]

Both variations, the "highest bid" as well as the "fairest bid", incentivize the partners to make fair and accurate valuations of the joint venture company's business, but involve, as a consequence of the lack of knowledge about the amount of the other partner's bid, a large element of risk or luck, given the serious consequences of getting the bid price wrong.[128] Further, it is crucial that the confidentiality of the third party can be ensured.[129] In order to avoid such risks, the partners could agree to sit down in front of the third party and to hold the auction in person.

Another variation is called the "second-price auction" or "Vickrey auction", which means that the partner submitted the higher bid price purchases the other partner's interest at the lower bid price submitted by the other partner.[130] By using a second-price auction structure, the partners are encouraged to submit bids stating the market value per share independent of the individual's risk preference and expectations about rival bidding behaviour (typically the maximum price they are willing to pay).[131] While in first-price auctions the partners are encouraged to bid less than the market value depending on risk preference and expectations about rival bids (typically a price

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[126] *Fleischer/Schneider*, DB 2010, 2713 (2714); *Hewitt*, p. 250.
[127] IncNow, *Delaware LLC Member Buyout Options: Shotgun. Baseball, DragAlong, Tag-Along, Rochambeau, Coin Flip* (available at: https://www.incnow.com/blog/2014/11/11/delaware-llc-member-buyout-options-shotgun-baseball-drag-along-tag-along-rochambeau-coin-flip/); *Knoblauch*, GesKR 4/2013, 551 (564).
[128] *Otto*, GmbHGR 1996, 16 (19); *Hewitt*, p. 250.
[129] *Otto*, GmbHGR 1996, 16 (19).
[130] https://en.wikipedia.org/wiki/Vickrey_auction.
[131] *Cox/Roberson/Smith*, REE 1982, 1 (32).

higher than the anticipated other partner's bid).[132] The second-price auction is, therefore, a good alternative for the seller as well as for the buyer since the partner who really values the joint venture company's business will buy it by paying the price determined by the seller.

Please refer to the following example of a clause which provides a Mexican Shoot-Out mechanism:

EXAMPLE CLAUSE: MEXICAN SHOOT-OUT CLAUSE[133]

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK MATTERS

6.2 [PRESERVATION MECHANISMS]

6.3 DEADLOCK RESOLUTION

6.3.1 Deadlock Resolution Notice. A "**Deadlock Resolution Notice**" is a notice served by one Partner on the other in which the server requires that the auction procedure set out under this Section 6.3 shall be conducted.

6.3.2 Auction Procedure. Both Partners may within [twenty-eight (28)] days after the receipt of the Deadlock Resolution Notice (the first day is the day after the day of receipt) submit Sealed Bids (as defined in Section 6.3.3) to [the senior partner of the Company's auditor | notary, [*name*] with office in [*address*]] or such other person as may be agreed by the Partners (the "**Bid Holder**"). The Bid Holder shall be instructed not to open the Sealed Bids until the expiry of the [twenty-eight (28)] days' period available.

6.3.3 Sealed Bid. A "**Sealed Bid**" is a bid made in writing and sealed in an envelope by either Partner to buy all of the other Partner's shares in the Company for the price (in cash and not on deferred terms) specified in the Sealed Bid which may be:

(a) positive and offer payment to the transferor of the shares; or

(b) negative and require payment to be made by the transferor of the shares,

but which in any case shall not be by reference to the sum offered by the other Partner.

6.3.4 No Revocation [and Lock-up Period]. A Sealed Bid:

(a) may not be revoked; and

(b) [may not be issued before the [first] anniversary of the date of this agreement].

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[132] *Cox/Roberson/Smith*, REE 1982, 1 (32).

[133] Please refer to fn. 107.

6.3.5 Completion. At the expiry of the [twenty-eight (28)] calendar days' period referred to in Section 6.3.2, the Bid Holder shall immediately notify each Partner and the Company in writing of the offers received (or, if no offers were received, that fact) and which is the best offer (determined in accordance with Section 6.3.6). On receipt of such notification, the Partner which has made the best offer as determined by the Bid Holder shall be bound to purchase and receive the other Partner's shares in the Company, and the other Partner shall be bound to sell and transfer its shares in the Company, at the (proportional) price set out in the [best offer | second best offer (if any)] and on the terms set out in Section [*COMPLETION OF THE SALE AND PURCHASE OF SHARES IN THE COMPANY*].

6.3.6 Best Offer. If both Partners have made an offer by Sealed Bid, where:

(a) both Partners' offers are positive offers to pay cash to the other Partner for its shares, the best offer shall be the highest cash sum offered;

(b) both Partners' offers are negative offers such that the transferor pays cash to the offering Partner, the best offer shall be the one that requires the lowest payment to be made by the transferor of the shares;

(c) one Partner's offer is a positive offer to pay cash to the other Partner and the other Partner's offer is a negative offer such that the transferor pays cash, the best offer shall be the positive offer.

6.3.7 Single Offer. If only one Partner makes an offer for the other Partner's shares by Sealed Bid and provided that such offer is for a positive cash sum, then the Partner making the offer shall be entitled to buy the shares of the other Partner at the price offered in the Sealed Bid. [However, if the other Partner disputes the price which has been offered, the Fair Value of the shares which are the subject of the offer shall be determined by an Expert appointed pursuant to Section [*EXPERT*] and in accordance with the valuation assumptions set out in Section [*TRANSFER FOLLOWING OBLIGATORY TRANSFER EVENT: VALUATION ASSUMPTIONS*]. The Fair Value so determined shall bind the Partners to sell and transfer, and to buy and receive, (as the case may be) its shares on the terms set out in Section [*COMPLETION OF THE SALE AND PURCHASE OF SHARES IN THE COMPANY*].]

6.3.8 Identical Offers. If the offers made by Sealed Bids pursuant to Section 6.3.2 are of an identical sum (and are both positive or both negative) then the offer first received by the Bid Holder shall be deemed to be the best offer.

If:

(a) the offers of an identical sum (which are both positive or both negative) are received or deemed to have been received simultaneously;

(b) no offers are made; or

(c) only one party makes an offer and such offer is for a negative sum, requiring a payment by the transferor,

then following notification by the Bid Holder in accordance with Section 6.3.5, the Company shall be wound up immediately.

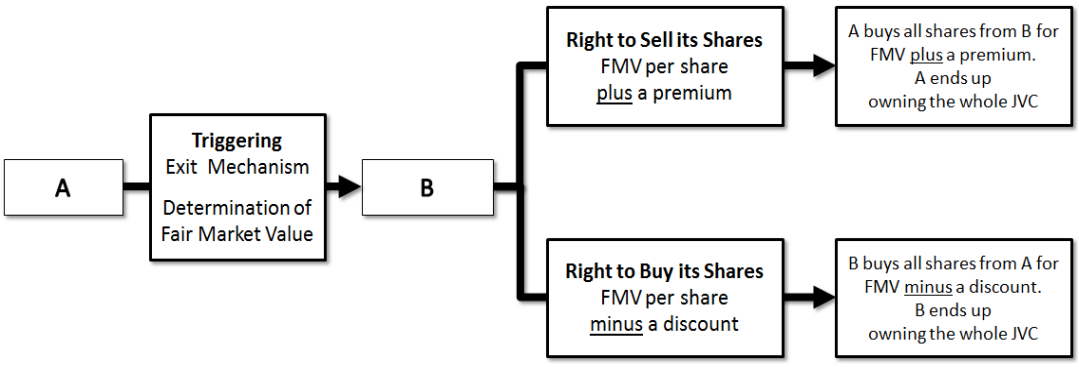
6.3.9 References. References in this Section 6.3 to shares held by a Partner in the Company are to all the shares in the Company held by that Partner and not to some only of those shares.

e) Deterrent Approach

Finally, there is a variation of buy-sell arrangements which disincentives the joint venture partners to trigger the deadlock resolution mechanism, encouraging the partners to come to a mutual agreement.[134] Triggering the deadlock resolution mechanism by either of the partners, the fair market value of the joint company will be determined according to a predetermined procedure (third party valuation, valuation method provided in the joint venture agreement, etc.). On the basis of such determined fair market value, the partner who has not initiated the deadlock resolution mechanism can either (i) acquire the interests of the initiating partner at the respective proportional price minus a predetermined discount (*e.g.*, 20%); or (ii) purchase its interests to the initiating partner at the respective proportional price plus a predetermined premium (*e.g.*, 120%). The predetermined discount/premium disincentives, therefore, the joint venture partners to trigger the exit mechanism – commonly known as ***Deterrent Approach***.[135]

In short, it follows the principle: Trigger the exit mechanism and bear the deterrent.

Deterrent Approach[136]



[134] *Fleischer/Schneider*, DB 2010, 2713 (2714).
[135] *Willms/Bicker*, BB 2014, 1347 (1348 *et seq.*); *Hewitt*, p. 251.
[136] Please refer to fn. 96.

Due to the determination of such deterrents, it is conceivable that the right to trigger the exit mechanism can be granted unconditionally, in particular without the requirement of the occurrence of a deadlock, and, therefore, without the requirement to define trigger events which are often disputed by the joint venture partners.[137]

However, such mechanism bears the risk that neither partner will trigger the exit mechanism (in the event of a deadlock) since neither of them wants to take the disadvantage of the respective deterrent.

Please refer to the following example of a clause which provides a deterrent approach:

EXAMPLE CLAUSE: DETERRENT APPROACH[138]

6 DEADLOCK AND DEADLOCK RESOLUTION

6.1 DEADLOCK

6.2 [PRESERVATION MECHANISMS]

6.3 DEADLOCK RESOLUTION

6.3.1 Deadlock Resolution Notice. A "**Deadlock Resolution Notice**" is a notice served by one Partner on the other in which the server requires that the Fair Market Price per share of the Company should be determined, as at the date of the Deadlock Resolution Notice, in accordance with the procedure set out in Section [*FAIR MARKET PRICE VALUATION PROCEDURE*].

6.3.2 No Revocation [and Lock-up Period]. A Deadlock Resolution Notice:

(a) may not be revoked; and

(b) [may not be served before the [first] anniversary of the date of this Agreement].

6.3.3 Counter-notice. Within [twenty-eight (28)] calendar days after the Fair Market Price has been determined and notified to each Partner (the first day is the day of the receipt by the recipient of the Deadlock Resolution Notice), the recipient of the Deadlock Resolution Notice shall be obliged to elect, by serving a counter-notice to the server of the Deadlock Resolution Notice, either of the following:

(a) to require the server of the Deadlock Resolution Notice to purchase, or to procure the purchase of, all that other Partner's shares in the Company at a price per share which is equal to [120]% (in words: [one hundred and twenty] per cent) of the Fair Market Price as determined; or

(b) to require the server of the Deadlock Resolution Notice to sell all its shares in the Company to that other Partner at a price per share which

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[137] *Knoblauch*, GesKR 4/2013, 551 (564).

[138] Wording based on: *Hewitt*, p. 763.

is equal to [80]% (in words: [eighty] per cent) of the Fair Market Price as determined.

6.3.4 No Counter-notice. If no counter-notice is served within the [twenty-eight (28)] calendar days' period pursuant to Section 6.3.3, the recipient of the Deadlock Resolution Notice is deemed to have made an election to sell its shares in accordance with Section 6.3.3(a).

6.3.5 Completion. If the recipient of the Deadlock Resolution Notice serves a counter-notice in accordance with Section 6.3.3, or is deemed to have made an election pursuant to Section 6.3.4, then the Partners shall be bound to sell and transfer, and to buy and receive, (as the case may be) its shares on the terms set out in Section [*COMPLETION OF THE SALE AND PURCHASE OF SHARES IN THE COMPANY*].

6.3.6 No Deadlock Resolution Notice. [reference is made to the "Example Clause: Texan Shoot-Out" in the Section D.VI.4.b) above].

6.3.7 References. [reference is made to the "Example Clause: Texan Shoot-Out" in the Section D.VI.4.b) above].

E. Conclusion

Taking into account that every (business) relationship usually benefits from constructive discussions about the thoughts and opinions of the different parties involved, the structure of the joint venture should enable the joint venture partners to share their divergent views. In order to address the risk that the partners are not able to come to an agreement, a mechanism should be in place ensuring that deadlocks can be dissolved and thus the venture can be prevented from negative consequences resulting therefrom.

In order to assure a productive exchange between them, the joint venture partners should, as a first step, consider limiting the scope of deadlock resolution mechanisms, in particular exit mechanisms, to disputes about matters which can have a significant negative economic effect on the joint business. Depending on the relevant circumstances, the definition of a deadlock as the trigger event can be determined as any dispute on the shareholder level only and/or the joint venture partners can include a catalogue of matters which shall have the respective commercial relevance. As a second step, prevention mechanisms, in particular a "cooling-off" period and/or an (tiered) escalation mechanism, can be included in the joint venture agreement to facilitate the finding of a compromise between the joint venture partners, but also, as a third and final step, the inclusion of a clear, forceful exit mechanism may strongly motivate the partners to reach a negotiated outcome.

As a specific type of exit mechanisms, shoot-out provisions allow a joint venture partner to buy out (to “shoot out”) the other partners as shareholders of the joint venture company through a formalised price determination process in order to dissolve a deadlock between them. These exit mechanisms are clearly structured, relatively quick and can be described as fair, since all partners have an equal opportunity to take over the joint business for a price determined by the respective process without having long negotiations. Most of the disadvantages and risks resulting from the inclusion of shoot-out mechanisms (*e.g.*, a partner could exploit its economically stronger position, lengthy bidding procedures, none of the partners exercise the mechanism, etc.) can be limited through contractual provisions.

If the joint venture partners consider these steps by drafting their joint venture agreement at the time of entering into the joint venture and use the numerous options available to combine and modify such deadlock resolution mechanisms, the joint venture partners as well as the joint venture company can benefit from such mechanisms in the event of a deadlock situation.

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