

## Luxembourg joint ventures

Publication - 02/01/2015

Joint ventures (**JV**) are not a particular term of art under Luxembourg law. Where a small number of active principals, voluntarily constitute a new, shared business enterprise, this can be for joint investment purposes or a joint commercial enterprise and it is not required to take any particular prescribed legal form.

That said, the form of vehicles most commonly adopted for JV are the following:

- private limited company (société à responsabilité limitée / Sàrl)
- public limited company (société anonyme / SA)
- incorporated limited partnership issuing shares (société en commandite par actions / SCA), and
- standard or special limited partnership (société en commandite simple / SCS, or société en commandite spéciale / SCSp).

Assuming that the JV is not formed to undertake a regulated activity or to issue securities to the public which specifically requires the form of an SA, the Sàrl is often the preferred vehicle in practice for a JV as it is less heavily regulated.

The limited partnership options (SCA/SCS/SCSp) often tend to be used in practice for investment JV deals, particularly where some principals intend not to be as closely involved in management decisions and therefore for whom a limited partner role may be more appropriate.

### Regulatory

When established for investment purposes, one of the first questions will be to confirm whether or not the vehicle is actually a JV rather than an alternate investment fund (**AIF**). If it is a fund then the regulatory requirements for the investment vehicle and its manager will be significantly different from the position of an unregulated JV. As a commercial matter, many of the governance / organisational points considered below would also not be applicable in a fund context.

In broad terms, a non-fund, investment JV will have the characteristics which place it outside the scope of AIF set out in the EU alternative investment fund managers directive (**AIFMD**).

The definition of an AIF under AIFMD is a collective investment undertaking (excluding UCITS) which:

- raises capital from a number of investors,
- with a view to investing it,
  - in accordance with a defined investment policy,
  - for the benefit of those investors.

An investment JV (ie non-AIF) will therefore not have one or more of these characteristics.

According to guidance issued by ESMA, this would include, for non-AIF JVs, one or more of the following:

- having a general commercial (or industrial) purpose such as a predominant business activity involving the production, purchase or sale of goods or commodities or the supply of non-financial services
- (for a non-investment JV), not pooling capital raised from investors for the purpose of investment with a view to generating a pooled return from acquiring, holding and selling investment assets
- the JV parties (ie the shareholders) having direct and on-going decision-making powers over operational matters relating to the daily management of the JV's assets extending substantially further than simply voting at shareholder meetings on (for example) merger, liquidation, directors or auditor appointments or approving annual accounts. Clearly an extensive list of "consent matters" in a joint venture agreement (**JVA**) requiring prior authorisation is relevant here.
- the absence of a defined investment policy about how pooled capital raised from investors is to be managed so as to generate a pooled return for investors. One or more of the following would indicate the existence of such a defined investment policy:
  - that the investment policy is determined and fixed prior to investors committing to invest
  - that the investment policy is set out in a document which becomes part of or is referred to in the vehicle's rules or constitution
  - that the investment vehicle (or its management vehicle) is bound by a legally enforceable obligation to investors to follow that defined investment policy
  - that the investment vehicle has set out investment guidelines to its management vehicle, other than a business strategy for a general commercial or industrial purposes which refer to
    - \* investing in asset categories or meeting restrictions on asset allocations
    - \* pursuing certain investment strategies
    - \* investing in particular geographies
    - \* applying restrictions on leverage
    - \* applying minimum investment holding periods, or
    - \* applying risk diversification requirements.

## Corporate aspects

As a matter of corporate law, the Sàrl is a flexible, quasi-partnership company, managed by its sole director or board of directors and providing limited liability to its shareholders. As a quasi-partnership company, the Sàrl does not operate within an extensive or onerous set of statutory requirements. It is however prohibited from making public offers, either of shares or of debt securities and from having a shareholder population in excess of forty members. In the case of a private JV enterprise between a small number of active principals, these limits are rarely relevant to practice.

The SA is a public, limited liability company which is able (in contrast to a Sàrl) to make offers of securities to the public, to have a wider shareholder base and provides a high level of confidentiality to investors. The SA shares certain common features with the UK Plc derived from the EU Second Companies Directive. Unless any specific reasons require an SA to be used, they are less frequently encountered as JV vehicles in practice due in part to the more extensive statutory environment which applies (compared to a Sàrl).

The SCA is a corporate limited partnership issuing share capital. This vehicle's limited partnership attributes make it a frequently encountered option for investment JV. Although a limited partnership (with one or more general partners and one or more limited partners), the SCA is however also subject to the same, more extensive statutory framework as the SA.

The SCA has been supplemented by the introduction of the SCSp, a transparent limited partnership without corporate personality, specifically modelled on Anglo-American forms of limited partnerships. Please refer to [www.ogier.com](http://www.ogier.com), Luxembourg, publications, "New limited partnerships" for a full summary.

## Joint venture agreement (JVA)

Joint venture enterprises are often characterised by the active involvement in management and operation of the enterprise of a small number of engaged, financially committed individuals. These individuals almost inevitably will put in place a reasonably detailed contractual framework at an early stage in the life of the JV to regulate the parameters of its operations and their respective rights and obligations in relation to it. This detailed contractual framework is usually found in either a joint venture agreement (**JVA**) or a shareholders agreement, which supplements the vehicle's constitutional documents.

Whilst the general position under Luxembourg law in relation to a JVA is based on freedom of contract for the parties to regulate the affairs of their joint venture as they see fit, the following points are however also relevant:

- the JVA should not contain provisions either contrary to the applicable Luxembourg corporate law requirements or the JV's articles of association
- the JVA should not contain provisions contrary to Luxembourg's judicial public policy (doctrine)
- certain points will also benefit from repetition in the JV's constitutional documents, in order to maximise compliance in practice by the JV parties and their binding nature in relation to third parties
- potential difficulties relating to proof of quantum of damages in any contractual enforcement action can also be mitigated through use of a liquidated damages clause. Under Luxembourg law such clauses are in principle valid subject to potential reduction in amount if the Court were to consider the quantification of damage to be manifestly excessive.

## JVA - applicable laws

In Luxembourg, the emphasis on the parties' freedom to contract includes the choice of the law that will apply to the JVA. Where, as is often the case, the joint venture parties are based in various jurisdictions internationally, they may well prefer to apply a law which is familiar to them to their JV arrangements, e.g. New York, English or German law, as appropriate. Such

choices will be recognised and applied by the Luxembourg Court provided (broadly) that this does not contravene any mandatory principles of Luxembourg law or policy.

The parties may alternatively prefer to apply Luxembourg law to their JVA, consistent with their selection of Luxembourg to domicile the JV.

## **JVA - Luxembourg law**

Whilst this briefing cannot summarise every aspect of Luxembourg contract law that may become relevant, the matters below are worth highlighting.

There are no prescribed formalities required in relation to the JVA. The JVA is simply a contract, signed by the parties. It is not required to be entered into before a notary, to take any special form, to be stamped or to be filed on any register. The JVA may be written in English without requiring translation into any of Luxembourg's national languages and the essential requirements for validity are uncontroversial. These factors allow amendment from time to time without the need for a notarial meeting and the absence of any filing requirement respects commercial / operational confidentiality.

In relation to content of the JVA, the basic principle is that freedom of contract applies, subject to non-conflict with Luxembourg companies law, judicial public policy and the vehicles' constitutional documents.

These non-conflict requirements apply (broadly) irrespective of whether Luxembourg or another system of law is selected.

Luxembourg law does however also provide the following additional principles of general application which may be particularly relevant in a JV context.

In relation to any Luxembourg law governed contract, an overriding duty of good faith applies between the parties not only in their performance of the contract but also in pre-contractual matters and in any ultimate enforcement that may become necessary. This generally applicable duty has two specific, additional areas of application in the corporate context: abuse of majority; and abuse of minority.

Abuse of majority may occur both in actions taken by shareholders and in actions taken by directors if those actions are:

- taken contrary to the general best corporate interests of the JV; and
- are taken either with the sole and exclusive intention to favour or prefer the majority shareholders to the detriment of the minority or to have, and to be intended to have, a damaging effect on the minority shareholders.

Abuse of minority refers to a situation where minority shareholders refuse to take decisions which are in the best corporate interests of the JV and includes both voting under the articles and taking decisions within the contractual framework of the JVA. Such refusal must be characterised by bad faith and be taken for exclusively self-referential, non-corporate reasons, contrary to the JV's best corporate interests and causing damage to the JV out of proportion to positive effects sought by the minority.

## **Non-conflict with Luxembourg corporate law**

### **Sàrl**

The relative flexibility, and quasi-partnership, statutory framework applicable to a Sàrl results in only one principal area of sensitivity in relation to a provisions commonly encountered in a JVA. This refers to provisions regarding the transfer of shares, e.g. exit, drag-along and tag-along provisions. Luxembourg corporate law views the approval of the identity of fellow members as being of paramount importance in quasi-partnership vehicles such as S.àr.l.

Therefore any proposal to transfer shares (other than by inheritance) to a new member must be approved by existing members holding at least 75% of the issued share capital by formal shareholder resolution, passed in a general meeting or by written resolution. Given the primacy of importance attached to the individual identities of members (as quasi-partners), it is not possible to pass such approving resolutions at the outset of the JV, blind as to the identity of proposed future transferees.

Unless supported by a proprietary security interest, the most that can be done is to include a contractual provision in the JVA where all JV parties agree to vote in favour of such a resolution. Agreements to vote are in principle valid, subject to certain conditions. The starting point for a remedy for breach of such provisions is a claim for damages, unless also set out in the JV articles of association, the availability of specific performance (*exécution forcée*) being limited.

### SA / SCA

The more extensive statutory regime applicable to SA and SCA contains different points of sensitivity in relation to frequently encountered JVA provisions.

Firstly, in relation to JVA provisions seeking to ensure the stability of the JV's shareholders, any provisions restricting the free transferability of shares should be at least limited in time and should not be contrary to the corporate interests of the company.

The principle of free transferability of shares in relation to an SA/SCA is also relevant in relation to requirements for the approval (either by the directors or by the other shareholders) of any proposed share transfers to third parties. In order to be valid, these clauses must provide for transfer to the remaining shareholders if approval of the proposed third party transferee is not forthcoming.

Pre-emption clauses requiring that proposed share transfers be first offered to the other shareholders, are valid, provided that they are sufficiently certain, for example in relation to the determining of the sale price.

Drag-along and tag-along clauses are not contrary to the provisions applicable to SA / SCA.

The frequently encountered provision for "consent matters", requiring that the directors only exercise their executive powers on behalf of the company in relation to specified types of decisions material to the business, are valid in principle. To ensure these matters apply in a constitutional sense in relation to the conduct of the JV's business requires that they be restated in the JV's constitutional documents. Care must be taken however to ensure they provide a framework for due authorisation by the directors and do not constitute a direction to the board. Any such direction would be prohibited under civil law corporate jurisprudence and, separately would also risk characterising the shareholders as *de facto* directors.

Similarly, clauses entitling certain shareholders the right to nominate certain directors (and requiring other shareholders to vote in favour of such appointments) are in principle valid, subject to not being contrary to the JV's best corporate interest and not depriving shareholders of their right to take part in discussion of such nominations.

## Profit allocation

In principle, the JV parties are free to determine profit allocation as they consider commercially appropriate, subject only to a generally applicable, longstop prohibition on clauses which purport to totally exclude certain shareholders from participation in profits or exposure to risk of loss. Such clauses are rare in practice between JV parties.

## Deadlock

Forfeiture / compulsory share purchase provisions are valid provided they do not deprive members of their shares without payment or deny members of the right to require dissolution of the JV for cause. Lawful causes to require such dissolution include: non-performance by a shareholder of its obligations; difficulty in continuing the JV's business; and deadlock between members which paralyses the functioning of the JV or which definitively compromises the future of the JV's business.

## Duration

JVA are subject to a general principle of civil contract law that no contract can be made for an infinite duration. This does not necessarily require that a fixed number of years be set out in the JVA. As many JVA are constituted for the purpose of a specific project with a required period of time or for a set investment period, reference to such a period for determining the duration of a JVA is an appropriate approach.

## Ensuring compliance

To ensure compliance with the commercially agreed position in practice, it is better to replicate certain clauses from the JVA in the JV's constitutional documents. If the clause appears solely in the JVA, the remedy for any breach will generally be a claim for damages with the related uncertainties associated with litigation risk including any difficulties of evidential proof. The availability of a Court order to compel mandatory performance (rather than a claim for damages following non-compliance) will often be uncertain.

In many circumstances, the JV parties will prefer (at least at the outset) that all parties simply comply with their agreed joint position in the business of the JV, rather than to seek financial compensation for breach, after the event. Thus, the matters set out below will often be included in the JV constitutional documents, breach of which results in immediate invalidity. Those constitutional documents can also be relied on against third parties by reason of their public filing and consequent registration at the Luxembourg companies registry, in the case of Sàrl, SA and SCA. The JVA, in contrast, being a private contract cannot be relied on against third parties.

However, as the JV constitutional documents are publically available on the Luxembourg companies' registry, a balance between (1) commercial confidentiality and (2) reliance against third parties and constitutional effect within the JV itself, may need to be struck. A common balance is to include at least the following provisions in both the JVA and the constitutional documents (although views do differ on individual provisions):

- share transfers
  - prior approval requirements
  - pre-emption rights and other obligations or restrictions

- management requirements
  - board composition, classes of directors, appointment rights of particular share classes,
  - special quorum, or majority requirements (also in relation to shareholders' meetings), provisions to deal with deadlock; consent/authorisation requirements
- drag-along and tag-along provisions
- share class rights
  - preferred distribution / profit share
  - voting rights

## Financing

Within the corporate limits on offers of securities to the public and AIFMD limits on raising capital for investment, JV are commonly financed by a blend of equity and specialist debt securities.

Please refer to the client briefing on [www.ogier.com](http://www.ogier.com), Luxembourg, publications, "Foreign direct investment - Structuring the equity".

Please also contact Ogier Luxembourg's specialist, structuring team for specific advice in each case.

## Authors:

Daniel Richards, Partner, Ogier Luxembourg  
Laurent Thailly, Senior Associate, Ogier Luxembourg

## About Ogier

Ogier provides practical advice on BVI, Cayman Islands, Guernsey, Jersey and Luxembourg law through its global network of offices. Ours is the only firm to advise on these five laws. We regularly win awards for the quality of our client service, our work and our people.

## Disclaimer

This client briefing has been prepared for clients and professional associates of Ogier. The information and expressions of opinion which it contains are not intended to be a comprehensive study or to provide legal advice and should not be treated as a substitute for specific advice concerning individual situations.

Regulatory information can be found at [www.ogier.com](http://www.ogier.com)

[ogier.com](http://ogier.com)



## Meet the Author



**Daniel Richards**  
**Practice partner**  
Luxembourg Legal  
daniel.richards@ogier.com  
T+352 2712 2011  
M+352 691 772 018

## Key Contacts



**Bertrand Gérardin**  
**Partner**  
Luxembourg Legal  
bertrand.geradin@ogier.com  
T+352 2712 2029  
M+352 691 751 027



**François Pfister**  
**Partner**  
Luxembourg Legal  
francois.pfister@ogier.com  
T+352 2712 2020  
M+352 621 317 818



**Laurent Thailly**  
**Partner**  
Luxembourg Legal  
laurent.thailly@ogier.com  
T+ 352 2712 2032  
M+352 621 245 402



**Virginie Gonella**  
**Counsel**  
Luxembourg Legal  
virginie.gonella@ogier.com  
T+352 2712 2022  
M+352 621 244 141

## Related services

Corporate