# AVOIDING THE PITFALLS OF A 50/50 JOINT VENTURE

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**The noble idea of launching an equal partnership between two partners should not obscure the potential pitfalls of such a venture. If one is determined to exclude any alternative solution which will slightly upset the balance (such as a third partner playing the role of third party arbitrator, a 49/51 split allowing the adoption of certain decisions by the majority partner alone, the decorrelation of financial and management rights), such a partnership must be scrupulously thought through and prepared in order to preserve the equilibrium and overcome potential blockages, in particular by introducing appropriate clauses in the partners' agreements.**

Why, how and for how long? The answers to these questions will enable two individuals wishing to form a 50/50 partnership to clearly define their expectations and common objectives and to set the parameters of their partnership in the partners' agreement and the articles of association of their company.

## Maintaining a balanced position

A 50/50 partnership means, first of all, a balance between the partners in their respective commitments, i.e. in their financial and personal contributions.

The financial investment, the amount of which will be fixed according to a business plan and projected investment and operating budgets, should be made in principle in equal shares, whether in equity capital (in cash or in kind) or in shareholder loans. While it is easy to ensure equality on incorporation of the company (particularly if the contribution is in cash), it is more complex to ensure that it is maintained during the life of the company, as the company develops and the resources and needs of each of the two partners evolve. It is therefore in their interest to agree initially on the principles they intend to follow:

- principles regarding distributions: for example, allocating profits to reserves until a certain amount of equity is reached, distributing dividends based on a percentage of distributable profits after certain thresholds are reached; and
- principles regarding the prioritization of the means of financing necessary for the company's development: equity, bank financing, shareholder loans, capital increases and others.

The distribution of net income generated by the investment (distribution of dividends or reserves, payment of interest on shareholder loans, capital gains in the event of simultaneous resale) can thereby remain strictly equal.

Defining the personal engagement of the two partners will certainly raise greater difficulties and debate. The partners will first have to agree on the operational role and contribution of each, as well as their remuneration. If the personal commitment and contribution of each partner are expected to be equal, so too should be their remuneration, and its evolution should be parallel (depending for example on objective criteria linked to the development of the company).

Secondly, in terms of governance: the SAS (*société par actions simplifiée*) is undoubtedly the most flexible corporate form, leaving more room for imagination. The only constraint in terms of governance of an SAS is the mandatory presence of a President, who represents the company with respect to third parties and is vested with the broadest powers to act on its behalf. However, unlike a limited liability company (*société à responsabilité limitée*), which can be managed by co-managers, it is not possible to have multiple Presidents of an SAS. To overcome this difficulty, a number of scenarios – and combinations – can be envisaged for joint management by the two partners:

- Appointment of a Managing Director (*Directeur général*) with powers identical to those of the President (and, like the President, named as an officer on the Commercial Register (*extrait K-bis*)), implying that each of them individually holds the power to take all management decisions in the interest of the company;
- Limitation of the powers of the President and the Managing Director on the most important management decisions, which must be subject either to a veto right of the other manager or to prior authorization by a collegiate body composed of the two partners; and/or
- Attribution of specific and/or technical powers to each manager, but equivalent in importance and investment.

Once proper thought has been given to the matter, the above principles should be laid down in the articles of association of the company or, if necessary for confidentiality purposes, in a shareholders' agreement.

## Overcoming deadlocks

Even if safeguards have been envisaged, certain deadlock situations may arise between the partners, whether on the day-to-day management of the company, or on more strategic decisions falling within the purview of the shareholders which by definition (neither partner having the majority) will require unanimity. It is therefore advisable to provide, in the articles of association and/or in the partners' agreement, for procedures aimed at preventing such deadlocks and resolving difficulties in good faith.

When the partners are individuals, the exercise is more delicate than when the partners are companies which can call upon their senior officers, other than those involved in the management of the joint venture, to overcome difficulties. If the partners are individuals, however, the following can be envisaged in the event of a conflict over a decision:

- a procedure for adjourned meetings of the decision-making bodies concerned by the deadlock, at intervals close enough to ensure the continuity of the business, but far enough apart to give the managers/partners time to examine the situation and reconsider the decision; then
- a non-institutionalized (and therefore flexible and inexpensive) procedure involving a third party, acting as mediator or conciliator.

It should be remembered that in the event of a deadlock between shareholders, each of them has the possibility of initiating a legal action for abuse of equality against the other, the sanction of which would be the granting of damages or the appointment of an *ad hoc* trustee who could find a way out of the impasse.

If, in spite of everything, a deadlock persists, in order to avoid penalizing the company, the partners can have recourse to more drastic procedures for breaking the deadlock, which would have been provided for in the articles of association and/or the partners' agreement, i.e. their divorce.

## Conflict resolution in cases of persistent deadlock

Exclusion (i.e. forced redemption) clauses are of no help in these situations, as it is settled case law that a partner cannot be excluded from the vote on his exclusion.

On the other hand, the typical clauses of shareholders' agreements will be of greater interest (such as the classic rights of pre-emption and approval, which are also applicable in the event of transfers by succession). Above all, exit clauses, such as the so-called "buy or sell" clause, may be usefully included in agreements between partners:

- A buy or sell clause (with more or less forceful variants) allows either partner to offer to the other to purchase his/her shares at a stated price, the latter partner then having the option either to accept this purchase offer or, on the contrary, to purchase the shares of the offering partner at the same price (the advantage of this clause is that it obliges the offering partner to propose a fair price, since he or she will not know if this will be applied to a purchase or sale of the shares).
- A withdrawal clause (also called a put option) gives either partner the possibility of withdrawing from the venture by selling his or her shares to the company or the other partner (at a price determined by an expert valuator if the partners do not agree on the amount).
- A joint exit clause (also called a drag-along right) allows a partner, in the absence of an amicable agreement on a separation, to cause the sale of the entire venture to a third party.

The circumstances in which these clauses can be invoked (usually a serious conflict putting at risk the success or survival of the venture), as well as the procedures to be followed, should be drafted with great care.

In conclusion, before entering into a 50/50 joint venture, future partners should consider the widest range of disagreements and points of friction, not necessarily to resolve them in advance, but to iron them out, frame their resolution and provide for possible solutions. The drafting of the articles of association and the shareholders' agreement is therefore essential, bearing in mind that in the event of failure, the partners will be left with the remedies provided by law – such as a petition to wind-up the venture on the grounds of irreconcilable differences or for the appointment of a receiver – which will, however, be available only if the partners' disagreement leads to a complete paralysis of the venture, by which time it may be too late to salvage any value.

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