

What should you know before setting a French Joint Ventures

Introduction

RATHEAUX law firm offers a global service covering all aspects of law, however the most common kinds of cases which we defend, regarding a JV would be breach of a partner undertaking, dispute between partners, dispute over royalties, patent, trademark or know how infringement made by one of the partners, tax claims and tax challenging abusive transfer pricing, labor law claims, dismissal procedure against key managers of the JV, downsizing with redundancies procedures.

A French avocat who specializes in joint ventures is often involved in the drafting of potential agreements between two investors who might not necessarily hold the same views of the target or how to reach it. This situation is complicated if at least one potential investor is a foreign company with his or her own cultural and legal background. The French lawyer will have a constructive approach, will explain to the parties what is legally possible, and attempt to bring both parties to a common understanding on how the JV will be settled.

French Court System

The French court system is comprised of local first level tribunals, several regional courts of appeal, and one Supreme Court (Cour de Cassation). France is divided into 96 metropolitan departments which are grouped in 22 regions. First level tribunals specialise in labor law (*Prud'hommes*), civil matters (*Tribunal d'instance* or *Tribunal de grande instance*), and commercial matters (*tribunal de commerce*) in almost every large town. There is one court of appeal located in each region.

This specialization occurs to insure work in specialized tribunals in a legal sector and to guarantee work with more experienced judges; the same goes for courts of appeal. The Supreme Court only verifies the legality of the decision made by a court of appeal. Because it does not review the facts, it is not technically considered another appeal step.

Judges/Juries

Except in criminal matters, there are no juries, only judges. The French court system is based on judgements to be issued by professional judges, reducing errors that would occur due to a mere citizen's subjective approach. The law is complex and because basic law principals are provided in code articles, there is a need for judges to have studied law.

As avocats, we know we will plead before professional judges, so we are spared trying to impress them with a factual approach. In this way, French courts are very different from American courts; for example, cross examination where lawyers try to convince a jury, does not exist in France (except for criminal cases). Instead, an avocat must focus on law rules, as enacted in a Code enabling the judge to consider that it is a relevant reference governing the issue. The avocat will explain to a judge how a fact can be linked to a law provision resulting in the solution on the rights and liability of each party. Furthermore, because a judge is a professional also specializing in a legal field, any explanation of a Code article is unnecessary. Since lengthy

explanations are avoided and such judicial expertise is present, the time used during hearing and pleadings is significantly reduced.

Basic Pleadings

Each party presents his/her position and tries to challenge the merits of the other one.

Description of Trial

The trial begins with a writ, a legal summons to come before a court, which is served by means of a bailiff (*huissier*). The court then has a first hearing during which a calendar of procedure is set to define a specific time frame for each party to prepare his/her full set of arguments. These arguments are officially passed to the plaintiff with a copy of relevant documentary evidence supporting his/her stand point and case law. The plaintiff will then have time (as fixed in the calendar of procedure) to reply with his/her counter arguments and evidence. This continues until each lawyer has nothing to add or to reply, and then the pleading commences.

The pleading begins with the claimant's avocat who underlines the legal situation of his/her client, for instance the breach of a contractual commitment made. Then the avocat endeavours to prove that the prejudice effectively suffered by his/her client supports the amount of damages claimed. The plaintiff's avocat then has a turn to plead by attempting to challenge the legal position and reduce the financial exposure of his/her client. The avocat may also choose to plead on key points explaining why his/her client had no choice but to terminate the contract.

The average length of a trial concerning commercial matters is about ten months for a first level court, eighteen months for a court of appeal, and two years for the Supreme Court. This is such a time consuming process because too many litigations exist at the same time, delaying the possibility for a court to hear and settle a case quickly. During this period of time both avocats will exchange their draft of pleading briefs and shall disclose any document or testimony they would like to refer to. In addition, this time is used to explore, under legal secrecy privilege, the possibility of creating an out of court arrangement and then deleting the case before the court.

In France, legal expenses induced by a trial are not exceptionally high and avocat's fees are extremely low when compared to UK barristers or US attorneys. Therefore, there are less deterrents when simply starting a case. The actual risk occurs when the court decides the amount of damages. An out of court arrangement, while the litigation is on its way, is a tremendous opportunity to reduce a client's financial exposure and avoid betting on what a court could have awarded, potentially.

Burden of Proof/Evidence

The burden of proof must be made by the parties involved, although an independent expert can be appointed by the court, upon request made by a party. Before starting to fight on the grounds of a dispute, it is frequently worth requesting to a judge to appoint an independent expert (for instance analysing from a technical point an issue, appraising the root cause of an alleged defect which will be a miles stone in term of liability and a way to support a claim). The claimant will

request such expert appointment. During the expert's investigation both parties (represented by their avocats) are summoned. They can provide replies to the questions raised by the expert or request from him to investigate another specific part of the problem.

Nature of Evidence – How Permitted

Only written testimonies and written documents are permitted as evidence. Oral arguments and testimonies are recorded in writing duly made, revised and signed by their author (and not by their avocat).

Document Disclosure Requirements

An avocat is not bound to disclose everything and can choose what he or she considers relevant to convince a judge. The avocat is also free to subpoena documents from the opposition.

Theories of Recovery

Seizure of assets is possible. If you want to be sure to be paid, you can organize during the drafting of the agreement the issuance of a collateral security, a bank guarantee, a mortgage on premise, or a pledge on assets. Once the deal is made, and litigation has begun, should you find that there are no previously structured tangible securities, you should try to freeze some assets. These assets could be subsequently sold through public auction once the court has rendered its judgement.

How Damages Are Awarded

Damages are awarded based on the prejudice proven (loss of profit, loss of margin, damage suffered). For example, a chartered accountant can prove a drop in sales and evidence the margin lost attached to the missing turnover. If it is a waste of reputation it will depend on the notoriety of the party blamed which will then increase the amount of damages awarded.

Who Pays Attorneys Fees

Each party pays his/her own lawyers' fees

Legal Aid

Legal aid is only available for individuals with minimum resources, but not for corporations. If legal aid is requested, the chief executive of the concerned bar association will appoint an avocat to defend such an individual. The avocat is usually a young avocat with small experience who informed the bar association that he or she was ready to assist.

Contingency Fees

In France, fees are estimated and a budget with different scales is set with each client before starting legal work. It is possible to have a flat fee completed by a success fee (it is forbidden to

have only success fees). The estimated budget is based on the time forecasted to be spent on the file, the complexity of the matter, and the predicted work load. Fees will of course be higher if the avocat is well known or if part of the work has to be made in a foreign language. Flat fees associated with a success fee are essentially used in debt collection or in tax litigation matters.

Rules for Representatives/Class Actions

Plaintiffs can group together and make the choice to appoint the same lawyer to conduct the claim in order to share procedural costs and fees. Class actions come from the United States and are still brand new in France. Currently I see mainly class actions grouping plaintiffs together who are suing companies for product liability. It appears that such grouping is effectively motivated by cost sharing.

Other Information

Professional judges are monitored by the French civil service (Minister of Justice). Young judges start at the local tribunal and once they have enough experience, they are appointed to a court of appeal. The timeframe for such a promotion varies and is based on internal procedure of the French Minister of Justice.

The French Legal System & its Pertinence to Joint Ventures

There is no specific court designated for cases involving joint ventures and partnerships. If the joint venture is made through a contract between two companies or by means of a new company, litigation will be made before a commercial court (Tribunal de Commerce), found in most large cities. Pleadings and documentary evidence must be made in French (certified translation is required for any foreign document used before the court).

The laws affecting companies do not vary at all in different parts of France. Foreign firms have the same rights as a French company.

Differences

With regard to tax law, almost everything is done in writing. Detailed explanations are written and filed officially with the court before the hearing. The lawyer therefore, is not expected to present his or her case, but merely outline major points or provide any clarification the court asks for directly. As a result, the hearing before a court specializing in tax matters is very brief. The best tax lawyers are former tax inspectors who have left the tax civil service and become attorneys. They bring with them not only their experience with tax matters, but also contacts with tax authorities, which is very useful to expedite the process of requesting a tax ruling or a specific tax regime.

Basics of Partnerships & Joint Ventures Law

Both potential partners should prepare, with the assistance of a local chartered accountant, a business plan with a financial forecast for at least two years. This is required to identify the financial support needed and when the breakeven point will be reached.

The commitments of each party should also be defined in a memorandum of understanding, noting what will be contributed by each party (in cash or in kind), any transfer of know-how, license of trademarks and patents, services agreements, and what will be the agreed remuneration. Moreover, this preliminary agreement should state how the joint venture will be managed.

Then it is usual to set up a new company that will be the joint venture corporate vehicle. In France, the most used form is a Societe par Actions Simplifiée (SAS), a corporation with limited liability. This structure is preferred because it is the only one which permits stating directly in the by-laws (*statuts*) the provisions usually set in a shareholder's agreement (first refusal right, tag along, swing man, buy or sell, etc.). Since these provisions are stated in the by-laws, the company is bound to respect these rules. If the same provisions were provided in a mere shareholder's agreement, any breach could only give right to damages (based on the prejudice really suffered); it is impossible to obtain enforcement of an undertaking not respected. Due to the fact that such provisions will become part of the by-laws, the company shall not recognize the validity of any infringement of the by-laws and could, for example, in case of a transfer of shares' ownership made without first respecting a first refusal right stated in the by laws, refuse to pass such an assignment in the shares register (specific compulsory book requested to trace any shares assignment).

This agreement should also contain a specific explanation regarding the French labor law system and the thirty-five hour work week, and the potential existence of a works committee, which is compulsory for a company having a workforce of fifty or more.. Such a committee is a mix of elected employees delegated to represent them and is presided over by the legal manger of the company. The Works committee shall be consulted on matters relating to general working conditions, continuing professional training, or any subject that might affect the personnel Another explanation shall be made on the separation in France between a salaried position as an employee and an upper management one having full power to act on behalf of the company. (These upper managers are referred to as "mandataire social" and are not considered as employees and hence won't receive unemployment benefits).

Important Issues to Consider

1. For tax and liability reasons, a company should be formed rather than using a partnership with no corporate veil. This is very important in case the company should need to declare bankruptcy in order to limit shareholder liability.
2. Even if the company's headquarters are not located in France, it is important to note that under French law, a branch office is considered as a permanent establishment, and subject

to local French taxation. It is therefore necessary to ensure that yearly balance sheets and financial statements are prepared in compliance with French accounting and tax rules.

3. Tax authorities may challenge transfer pricing which would reduce artificially profits made in France. Transfer pricing is a way to invoice products or services from one company (increasing its profits) to another company reducing its taxable profit thanks to this invoice. If the amount invoiced is exceeding the value of a regular sale or is not sufficiently supported by evidence of the reality of the services rendered, it could be considered by local tax authorities as artificial and the burden would be fully or partially rejected.
4. Tax treaties will be checked regarding taxation of dividends and potential withholding tax if paid to a non-EU parent company. A way to avoid that could be to have a mother holding company based in an EU country with a tax treaty avoiding any withholding taxation on dividends allotted to a non-EU grandparent company.
5. Foreign officers being non-EU nationals that need to stay for long periods of time in France must first fill out a request for a long-stay visa with the French Consulate in the country where he/she has his/her home address.
6. Any person over the age of eighteen years that intends to reside for periods of time exceeding three months in France will have to request a residence permit (*Carte de séjour*) within three months of their arrival in France at the local Prefecture (French department governmental authority).
7. An individual who will have the power to represent a company in France, such as a president in an SAS, or Directeur Général in a “société anonyme” (regular corporation), or a manager (*Gérant*) in a EURL (limited liability company), must have a special business permit (*carte d’identité de commerçant étranger*) prior to his/her appointment in such position. The major exception to the business permit requirement is for EU nationals or foreign nationals holding a ten-year residence permit.
8. Documentation drafted during the preparation of agreements and of the joint venture corporate vehicle are referring to legal rules incorporated in Codes (tax Code, Labour Code, Commerce Code). This means that it is not necessary to use very long sentences to clarify issues or to refer to case law precedent as currently made in Anglo-Saxon and US documents, because main legal notions are already within the wording of specific Code articles. This does help while drafting a document and reduces the size of documents signed on the closing date.

Legal Proceedings

Steps

It is always best to attempt to reach an amicable settlement either directly between the two parties or through their lawyers. It could be also possible to use the swing man procedure where you pass the dispute to a third party who is neutral and could help to find a solution.

If no amicable arrangement is possible, in traditional commercial litigation the claimant will serve a writ by means of a bailiff and register the case before a court in order to open a lawsuit. In said writ he shall list his claims, their reasons and any amount of damages requested. Nevertheless, because in a JV the goal is not really to get some damages but to gain the control of the JV or withdraw from it, a buy or sell clause is generally stated and could be enforced.

Thanks to this buy or sell clause , within a specified timeframe, one party will propose by a letter sent to a neutral third party (already identified in the clause) a price either for selling his stake or buying all the shares of the other party. The other party will make his own price proposal in same time frame and doesn't know the price already proposed. The one making the higher proposal is, according to the said clause, automatically placed as the buyer of all the shares of the other party. It is also possible to ask a court to enforce the sale resulting from the buy or sell if one party doesn't respect his undertaking to sell as a result of the buy or sell clause.

Filing a Tax Joint Venture-Associated Lawsuit (that is intended to go to trial)

For a tax dispute first step is to review the tax notification issued by the tax authority stating a proposal to make an additional taxation and the reasons why (i.e., error made by the company on its tax results, alleged abusive tax deduction made etc), which opens for the company a compulsory 30 days period to make a written reply (otherwise you are deemed to have accepted what was stated in the tax notification). During such time it is possible to organise a meeting with the person in charge of the tax notification and, if necessary, to ask the attendance of a higher tax executive from the tax authority. This is still an amicable procedure where we expose the reasons and arguments which could entail the company to pay less tax than the amount requested or the tax deduction challenged.

Steps

Once the tax authority has received the company reply, they have no specific timeframe *to* make their own respond to the company reply. When the tax authority response is received, (accepting or denying the company's arguments, the company may decide to request the advice from the "commission departementale administrative" (local regional commission) which will review the case and give an opinion which will be either followed by the parties or refused, but this opinion can be used later if the dispute goes before a court.

The tax authority will then issue a notice of assessment requesting the payment of additional taxation. If the company is not agreeing the grounds used by the tax authority and the amount

requested, it could either pay the amount and form a claim, or refuse to pay but must offer a collateral security to secure payment of the taxation requested.

The tax authority will have a separate service which will examine the claim and later on send a notice for acceptance in full or partially or reject such claim.

Should the tax authority rejects the claim, the company can start a litigation before the tribunal administratif or tribunal de grande instance (depending on the nature of the taxation challenged), with a possibility to make an appeal for a second review of same case. Should the company win the case, if the amount of additional taxation has been paid by the company, it will obtain a tax refund, with an accrued interest.

Should the company lose the case the amount of additional tax remaining to be paid will bring accruing interest at the rate of 4.80% per year (this is the new interest rate as from 1st of January 2008).

Alternative Dispute Resolution

Alternative dispute resolutions are not really often used. Parties prefer an arbitration procedure, which could be held in English.

Strategies for Success

I find a global approach—including a cross-checking examination of legal, tax and labour issues—to be a successful strategy. This ensures that both parties (and their lawyers) will share the same view on the purpose of the Joint Venture, how it will be financed and operated, as well as how managing power will be steered or shared. Thanks to the legal privilege, a foreign client should be encouraged to tell his French lawyer not only to tell the official story, but what he has really in mind for the Joint Venture. This will help to customize the deal, as the attorney will be able to accommodate both the told or untold purpose. Clients should always see their French lawyer as a deal maker, not a deal breaker.

Good Advice

Never try to bring a ready-to-use homemade joint venture agreement or try to duplicate something that has been made somewhere else. These documents should only be used as examples of what is sought in order to clarify what the party has in mind and what is legal under the local law. There is a real need to adapt to local standards while customizing the deal and be ready to face big cultural differences. A direct bargaining approach while negotiating the deal may come across as a rude attitude and have a detrimental impact.

Recent Changes

The NRE law has reformed the French merger review procedure. This reform was strongly inspired by EU Regulation 4064/89 of December 21, 1989, which requires a prior notification to the European Union Commission of mergers and acquisitions exceeding certain thresholds

expressed in terms of turnover. French merger review procedures apply to what French law calls “concentrations.” According to French law, a transaction might be a concentration in the two following cases (article L430-1 of the French commercial Code):

Mergers and/ or Acquisitions

A concentration is deemed to occur when one or more persons, already controlling at least one undertaking, acquire, directly or indirectly, control of one or more other enterprises. Acquisitions involve the purchase of stock of a target company, of business assets, or any other contractual means (such as a merger) transferring control of one or more undertakings.

Common Enterprise “Joint Venture”

The creation of a common enterprise may be considered as a concentration when two undertakings conduct themselves durably as a single autonomous economic unit.

Applicable thresholds: Pursuant to new Commercial code article L430-2, as modified by NRE law, a concentration is subject to a pre-merger control from the French authority if the following cumulative thresholds are surpassed:

1. The worldwide turnover—excluding Value Added Tax (VAT, which is added to invoice of products or services rendered in France)—of all undertakings to the transaction exceeds €150 million
2. The French turnover (excluding VAT) made by at least two of the parties to the concentration process exceeds €50 million.
3. The Minister of Economy in the French government (i.e., the Department of Finance) is notified when a transaction surpasses the above-mentioned thresholds. the local service in charge on behalf of the French government is the agency of concentrations and aids (B3) This is the name of the specific bureau (desk) named B3. When a common enterprise is formed, all the parties concerned must notify the Minister of Economy services the transaction (article L430-3 of the French commercial Code).

Conclusion

Over the next five to ten years, the major changes expected should come from EU laws trying to set common standard rules. A first step has been made with the European company structure, which currently appears to be too complex to be effectively chosen as the common format for international groups spreading over Europe.

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