DEFENSE TRADE ADVISORY GROUP

Tasking Letter, August 2022 – DTAG Plenary, November 9, 2022
Working Group 3 White Paper - Joint Ventures

EXECUTIVE SUMMARY:

In August 2022, the State Department's Directorate of Defense Trade Controls (DDTC) tasked the Defense Trade Advisory Group (DTAG) to provide insight on industry perceptions of their obligations related to Joint Venture (JV) arrangements.

Working Group 3/Task: Joint Ventures (JV)

Background: DDTC has identified concerns with "joint ventures," given they are business entities created by two or more parties, generally characterized by shared ownership, shared returns and risks, and shared governance. Because of potential ITAR compliance challenges with JVs, DDTC seeks to become better informed on how JV agreements comply with the ITAR.

Tasking: DDTC requests the DTAG address this question: What factors should parent companies take into consideration to ensure that joint ventures comply with the various requirements of the ITAR?

POC: DTCC Jae Shin and Dan Cook

To respond to this tasking, the Working Group (WG) researched JVs to identify the various business formations and entities that may be considered a JV and compiled a summary of the different forms that a JV may take. The WG engaged in extensive discussions among the DTAG membership to identify key considerations for determining and assessing the ITAR compliance requirements in the context of forming and operating JVs.

As a result of this work, the WG provided the following recommendations, which were adopted by the DTAG at the November 9, 2022 plenary. In summary, these recommendations are:

1. JVs can exist in a variety of legal forms and business arrangements. There is not one standard form of a JV. As such, the WG recommends that DDTC approach JV registration with flexibility to accommodate the diverse entity structures of JVs.
2. The ITAR and principles of compliance apply to JVs the same as any entity engaged in ITAR activities. JVs engaged in ITAR-controlled activities must adhere to the same ITAR requirements and implement compliance policies and procedures as any other business entity. The WG recommends that DDTC not view or treat JVs differently from other business entities.
3. The WG recommends that DDTC publish frequently asked questions (FAQ) to provide industry with guidance on key considerations for determining when to register a JV. DTAG offers its assistance to DDTC with the development of such FAQs.

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TASKING:

Background: DDTC has identified concerns with "JVs," given they are business entities created by two or more parties, generally characterized by shared ownership, shared returns and risks, and shared governance. Because of potential ITAR compliance challenges with JVs, DDTC seeks to become better informed on how JV agreements comply with the ITAR.

Tasking: DDTC requests the DTAG address this question: What factors should parent companies take into consideration to ensure that JVs comply with the various requirements of the ITAR?

METHODS:

WG Research and Discussion: The WG conducted extensive research on JVs to gain an understanding of the various business structures that are considered JVs and the unique characteristics of each. This information is compiled in a summary form that is appended to this white paper.

Engaged in Discussions of Direct Experiences with JVs: The WG engaged in extensive discussions with the WG members to identify challenges faced by industry engaged in JVs and the various approaches taken to address ITAR registration and other ITAR compliance matters with respect to JVs. The WG reviewed samples of JVs and discussed various models of ITAR compliance utilized by industry. The learnings from these discussions are reflected in the JV considerations discussed below.

Consulted with DDTC: DDTC was available throughout the work of the WG to assist clarifying and focusing the task of the WG.

Prepared Recommendations: Lastly, the WG provided three recommendations for DDTC to consider as it expands its understanding of JVs and deliberates on a policy or approach for addressing perceived challenges with JVs and ITAR compliance requirements. These recommendations are detailed below.

DISCUSSION

I. Legal and Regulatory Background on JVs

The term JV is a legal fiction created at common law under state laws and through court decisions dating back to the late 19th century.[1] In other words, there is no one legal definition of "joint venture" in the United States, nor one federal law identifying how to define the term.[2] The fiction reflects one of several avenues through which parties may collaborate. Therefore, the formation of a JV is a fact-specific analysis. No one element or factor governs whether a JV exists, and courts generally look to a "totality of circumstances" standard to assess the scope, power, and authorities of the JV.[3]

Most JV requirements are established by the states. This means there are potentially 50 individual statutes and regulations that govern the formation of a JV. While some states, such as New York, New Jersey, Missouri, North Dakota, Delaware, and California represent states where several joint ventures are established, these states do not necessarily reflect the most frequent jurisdictions used.

Because 50 different states define how joint ventures are formed and what they may do, inconsistencies exist.[4] These inconsistencies are compounded by the fact that some JVs are formed under non-US laws, each of which may have additional requirements for this vehicle.[5] The most oft cited inconsistencies relate to joint venture organization, limitations of liability, asset contribution, management, and revenue issues.[6]

JVs are generally viewed as a combination of two or more parties that look to engage as one enterprise for a targeted purpose.[7] More precisely, "a joint venture is an association of two or more natural or juridical persons to carry on as co-owners [of] an enterprise, venture, or operation for the duration of that particular transaction or series of transactions for a limited time."[8] State laws and

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[1] H. W. Nichols, "Joint Ventures," 36 Va. L. Rev. 425, 428 (1950).

[2] Certain laws, such as the Internal Review Service code, define the term for specific requirements. *See, e.g.,* 26 USC §§ 701, *et seq*.

[3] K. E. Olson, Joint Ventures – Essential Elements: The North Dakota Supreme Court Creates a Broader Definition of Joint Ventures, 85 North Dakota L. Rev. 468, 479 (2009).

[4] *Compare* C. W. Byrd, Muddied Waters: A Review of Joint Venture Jurisprudence in Missouri, 85 Mo. L. Rev. 1113 (2020) (noting that joint venture jurisprudence in Missouri varies from other jurisdictions resulting in distortions of the elements required to establish a joint venture, citing Johnson v. Pacific Intermountain Express Co., 662 S.W.2d 237, 238 (Mo. 1983)) *with* K. E. Olson, supra n. 3 (noting same with respect to North Dakota).

[5] *See, e.g.*, M. Chetwin, The Broad Concept of Joint Venture: Should It Have a Fixed Leaning Meaning, 2007 EABR (Business) & ETCL (Teaching) Conference Proceedings, Ljubljana, Slovenia (and cases cited therein).

[6] *See supra*, n. 4.

[7] *See, e.g.*, Nichols, *supra* n. 1.

[8] Joseph Taubman, What Constitutes a Joint Venture, 41 Cornell L. Rev. 640, 641 (1956). *See also* Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928); Leitner v. Wass, 63 N.Y.S.2d 350, 352 (Sup. Ct. N.Y. County, 1946); SPW Associates LLP v. Anderson, 718 N.W.2d 580 (N.D. 2006); Voltz v. Dudgeon, 334 N.W.2d 204, 206 (N.D. 1983); Bader Farms v. Monsanto Co., 431 F.Supp.3d 1084, 1093-1096 (E.D. Mo. 2019).

court cases do identify certain common elements of a JV to distinguish this vehicle from other similar collaborative forms, such as teaming arrangements, partnerships, or joint trusts.

> Although its [JV] existence depends on the facts and circumstances of each particular case, and while no definite rules have been promulgated which will apply generally to all situations, the [court] decisions are in substantial agreement that the following factors must be present [to have a JV]:
>
> (a) A contribution by the parties of money, property, effort, knowledge, skill or other asset to a common undertaking;
> (b) A joint property interest in the subject matter of the venture;
> (c) A right of mutual control or management of the enterprise;
> (d) Expectation of profit, or the presence of "adventure," as it is sometimes called;
> (e) A right to participate in the profits; [and]
> (f) Most usually, limitation of the objective to a single undertaking or an ad hoc enterprise.[9]

There are numerous reasons why parties may create a JV and JVs can exist in a variety of different business structures and arrangements. JVs allow the partnering entities to pool resources and share the risk associated with capital-intensive projects such as funding mutually beneficial research and development or pursing business opportunities outside the core businesses of the partnering entities. JVs can serve as a vehicle for partnering entities to manufacture or market jointly develop products. They can also be a way for companies to satisfy foreign investment or local ownership requirements that may exist in foreign jurisdictions. The purpose of the JV often determines how the JV is structured.

II. JV Structure and Organization Variations

JVs can vary significantly from one another depending on the parties involved, the purpose and structure of the JV. The formation or structure will depend on the following factors:

- The laws of the state where the JV exists;
- The purpose and activities of the JV;
- The governance and management of the JV;
- The role and contribution of the partnering entities;
- Applicable regulatory requirements; and
- Other applicable laws, including non-U.S. laws if the JV is formed outside the U.S. or an equity holder is a non-U.S. entity.

[9] Robert Steinbuch, A Critique of the Second Circuit's Analysis of New York and New Jersey Joint Venture Law in Arditi v. Dubitzky and Sagamore Corp. v. Diamon West Energy Corp., 1 N.Y. City L. Rev. 445, 446 (1996) (citations omitted). *See also* Note, Joint Venture or Partnership, 19 Fordham L. Rev. 114 (1949).

The partnering entities that form the JV can also vary. The entities involved with the JV can be private or publicly held companies. Government entities could be involved, as well as foreign entities. The WG identified at least 17 different combinations of partnering entities:

- US private parties
- US public parties
- US public party and US Government party
- US private party and non-US private party
- US private party and non-US public party
- US private party and non-US government party
- US public party and non-US private party
- US public party and non-US public party
- US public party and non-US government party
- Non-US private parties
- Non-US public parties
- Non-US private party and non-US public party
- Non-US private party and non-US government party
- Non-US public party and non-US private party
- Non-US public party and non-US government party
- Non-US government parties
- US Government party and non-US government party

The nationality of the partnering entity is important because non-U.S. entities could raise concerns with other national security regulations such as the Committee on Foreign Investment in the U.S. (CFIUS). This is particularly true if the JV will be involved in ITAR-controlled activities.

The factors mentioned above will influence how the JV will relate to the partnering entities. The JV may be established as a subsidiary or affiliate of one of the partnering entities or it may be established as a stand-alone entity with its own management and operational structure and resources that are independent of the partnering entities. A JV is not automatically a subsidiary or affiliate of a partnering entity.

A JV may be controlled by a partnering entity with a clear majority of the ownership, or it may be evenly shared among the partnering entities. How the JV will be controlled and who will control it will be subject to negotiations of the partnering entities and could reflect a wide number of shared controlled arrangements. Often the control reflects the number of resources contributed to the JV by each partnering entity. The partnering entities may contribute monetary capital, equipment, infrastructure, policies, or any other resource deemed beneficial to the JV.

Staffing of JVs is another feature of JVs that can vary greatly. A JV may be staffed by direct hire employees, or it could be staffed by employees of the partnering entities that are seconded to the JV. It is not uncommon for a JV not to have any employees. There are any number of reasons where the partnering entities may choose to utilize their existing resources and employees to carry the activities of the business venture and allow the JV to exist only as a legal entity on paper.

III. JV Agreements

JVs are usually complex transactions governed by legal agreements. There is no one type of agreement or single set of governing agreement terms. The purpose of the agreement is to establish the JV as a legal entity and set the foundation for how the JV will operate. The partnering entities may enter into other transactional or commercial agreements to:

- License intellectual property to the JV or establish the ownership of intellectual property created by the JV;
- "Sell" or "loan" from the partnering entities to the JV information technology, equipment, services, etc.; or
- Define and establish commercial relationships among the JV and the partnering entities.

It is common for JV agreements terms to address the following topics:

- Size and composition of board of directors or equivalent, including rights of JV equity holders to appoint directors;
- Responsibilities of JV management, including rights of JV equity holders to appoint management (or not) and to participate (or not) in decisions of the JV;
- Purpose and scope of the JV;
- Contributions by the JV equity holders;
- Distribution of JV profits and responsibility for liabilities;
- Ownership of Intellectual Property created or used by the JV; and
- Legal and regulatory compliance obligations.

Each JV agreement will be drafted by the partnering entities to reflect the specific structure and operation of the JV.

ITAR Compliance Issues

I. General Considerations Relevant to ITAR Compliance

There are many considerations the partnering entities must consider when determining the best approach to address the JV's ITAR compliance requirements. Of primary importance are (1) the business in which the JV will engage; (2) the terms of the operating or formation agreements; and (3) the jurisdiction(s) holding authority over the JV's operations and activities, which may be a relevant consideration if there is a statutory or regulatory rule that affects control.

The starting point for evaluating ITAR compliance for a JV, as with any entity, is to understand the JV's purpose and operations. For example:

- Whether the JV will engage in the manufacture or export of defense articles or defense services;

- The data products and data handled by the JV and their classifications; and
- Whether the JV will receive or export intellectual property or technical data and any involvement of foreign persons.

The JV agreement will likely establish who will control the JV operations and how. If management responsibility is shared among the partnering entities (this may not always be the case), the agreement may detail allocation of the JV's compliance program and activities.

Bottom line, JVs should enact an export compliance program that fits its structure and operations and ensures the organization meets its regulatory obligations. In this sense, JVs are no different from any other company when it comes to ITAR compliance and no higher level of compliance risk simply by virtue of being a JV.

II. Registration

Because the ITAR has limited jurisdiction, the first question is necessarily whether the JV's activities will trigger ITAR control because of manufacturing, exporting, temporarily importing, or brokering "defense articles."[10] For purposes of this review, we assume the JV will engage in ITAR-controlled activities through manufacturing, exporting, temporarily importing and/or brokering and must comply with the registration requirements of 22 C.F.R. § 122.1. Considering the various ownership and organizational forms a JV can take, there are several factors to consider when deciding if the JV should register as a stand-alone entity or if the JV should be added to the existing registration of one of the partnering entities.

22 C.F.R. § 122.4 requires that DDTC be notified of the establishment of a U.S. or foreign subsidiary, or other affiliate engaged in manufacturing defense articles or exporting defense articles or defense

[10] The ITAR defines **"defense article"** in 22 C.F.R. § 120.31 as any item or technical data designated in § 121.1. The term includes:

(1) Technical data recorded or stored in any physical form, models, mockups or other items that reveal technical data directly relating to items designated in § 121.1; and
(2) Forgings, castings, and other unfinished products, such as extrusions and machined bodies, that have reached a stage in manufacturing where they are clearly identifiable by mechanical properties, material composition, geometry, or function as defense articles. The term does not include basic marketing information on function or purpose or general system descriptions.

"Technical data" is defined in 22 C.F.R. § 120.33 as:

(1) Information, other than software as defined in § 120.40(g), which is required for the design, development, production, manufacture, assembly, operation, repair, testing, maintenance, or modification of defense articles. This includes information in the form of blueprints, drawings, photographs, plans, instructions, or documentation;
(2) Classified information relating to defense articles and defense services on the U.S. Munitions List and 600-series items controlled by the Commerce Control List;
(3) Information covered by an invention secrecy order; or
(4) Software (see § 120.40(g)) directly related to defense articles.

Technical data does not include information concerning general scientific, mathematical, or engineering principles commonly taught in schools, colleges, and universities, or information in the public domain as defined in § 120.34 or telemetry data as defined in note 3 to Category XV(f) of § 121.1. It also does not include basic marketing information on function or purpose or general system descriptions of defense articles.

services. The ITAR defines an “affiliate” of a registrant as “a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such registrant.” 22 C.F.R. § 120.66(a). For purposes of this definition, “control” means “having the authority or ability to establish or direct the general policies or day-to-day operations of the firm. Control is rebuttably presumed to exist where there is ownership of 25 percent or more of the outstanding voting securities if no other person controls an equal or larger percentage.” 22 C.F.R. § 120.66(b).

We caution that a JV is ***not*** automatically a subsidiary or an affiliate of an ITAR registrant. When assessing whether the JV is a subsidiary or affiliate of an ITAR-registered entity, several factors should be considered, including:

- Ownership distribution of the JV;
- Management control of the JV;
- Whether there is an independent board of directors;
- Terms of the JV agreement (e.g., veto rights of a minority equity holder); or
- Staffing and resources of the JV.

When further assessing whether the JV should complete its own ITAR registration or should be included in an existing registration there are additional factors to consider:

- Whether any of the partnering entities are registered;
- Whether any of the partnering entities are non-US entities;
- What is the ownership split among the partnering entities; and
- How control of the JV is arranged among the partnering entities.

The partnering entities will consider these and other factors to determine if it is appropriate to include the JV on an existing ITAR registration or create a new registration in the name of the JV where it exists as a stand-alone company.

III. Compliance Program

Responsibility for the JV’s compliance with the ITAR will fall to the responsible ITAR registrant. That may be the JV itself, where it is the registered entity, or it may be the ITAR registrant that includes the JV in its registration. In either case, the principles of compliance that apply to all companies apply to the JV. The ITAR registrant will be responsible for ensuring that the operation and activities of the JV comply with the ITAR. The responsible registrant must ensure that a compliance program for the JV is developed and maintained. The size and complexity of the compliance program will depend on the characteristics of the JV and its activities and operations. This is no different from how any company would develop its compliance program.

Appendix 1 includes a matrix summarizing JV ITAR compliance considerations.

RECOMMENDATIONS

Recommendation 1

JVs can exist in a variety of legal forms and business arrangements. There is not one standard form of a JV. As such, the WG recommends that DDTC maintain a policy approach to assessing JV registration and compliance requirements that is flexible to accommodate the diverse entity structures and unique circumstances that exist with join ventures.

Recommendation 2

The ITAR and principles of compliance apply to JVs the same as any entity engaged in ITAR activities. JVs engaged in ITAR-controlled activities must adhere to the same ITAR requirements and implement compliance policies and procedures as any other business entity. The WG recommends that DDTC not view or treat JVs differently from other business entities.

Recommendation 3

JVs are unique business entities that can exist in a variety of forms. The WG recommends that DDTC publish frequently asked questions (FAQ) to provide industry with guidance on key considerations for determining when to register a JV. DTAG offers its assistance to DDTC with the development of such FAQs.

CONCLUSION

The WG provides information on JVs and the many compliance considerations to assist with DDTC's general knowledge and understanding of JVs. DTAG believes this information will assist DDTC with addressing compliance issues involving JVs and the development of any compliance policies unique JVs.

APPENDIX 1

Compliance Considerations Summary Matrix

COMPLIANCE CONSIDERATIONS			
	Is the JV subject to U.S. jurisdiction?	**Must the JV register under the ITAR?**	**What should the JV consider when implementing a compliance program?**
JV Corporate Structure	- Where is the JV incorporated? - Are any of the JV partners subject to U.S. jurisdiction? - How is the JV structured? - What is the purpose of the JV? -Governance? -Are there any other regulatory requirements? -Who controls the operation?	- Is the JV a "subsidiary" of one of the partners? - Does the JV have a majority owner? - Is the JV a 'stand-alone' entity?	- What rights and responsibilities are conferred on the partners under the JV agreements? - Under what circumstances may a JV partner sell its stake or acquire a larger stake? - What are the nationalities of the JV partners and the JV itself?
JV Management	- Will U.S./Foreign persons be involved in managing the JV? Both? - Will any U.S. partners be involved in managing the JV?	- Will the JV be managed / operated by one or more of the partners or will it act independently?	- Will foreign owners or employees be involved in decision making? - How will intellectual property created and/or used by the JV be treated? - Will the JV have its own compliance program, including policies and procedures, or will it rely on one or more of the JV partners?
JV Activities	- Will the JV operate in the U.S.? - Will the JV engage in activities related to U.S.-origin items (i.e., items subject to the ITAR or EAR)?	- Will the JV engage in one or more instances of manufacturing or exporting ITAR-controlled items? - Will the JV act as a broker for foreign sales of defense items?	- Will the JV have its own infrastructure (employees, purchasing, IT systems, etc.) or will it borrow services and equipment from the JV partners? - What is the purpose and scope of the JV? - Will the JV operate across borders (e.g., international locations, customers, or suppliers)?