

Case 16-6
Closely Associated Cars

JV, a corporation, was formed in 2013 to design and manufacture electric cars. JV is 60 percent owned by AutoCo (a car manufacturer) and 40 percent owned by ElectricCo (a developer of electric car technology). The decision-making authority of JV is equally shared between AutoCo and ElectricCo: the board of directors of JV is comprised of two members appointed by AutoCo and two members appointed by ElectricCo. JV's board of directors (1) set the annual budgets; (2) responsible for the hiring, firing, and compensation of management; and (3) approve all material contracts. As part of the agreement, all cars produced by JV will bear AutoCo's logo and will be sold at AutoCo-branded auto dealers.

AutoCo is an established car manufacturer that has been producing cars in the United States for the past century. To meet governmental mandates of lowering emissions and increasing the fuel economy of its fleet, AutoCo has been evaluating various ways to enter the electric vehicle market. AutoCo does not currently have viable technology for the production of electric cars.

ElectricCo was established by professors that developed cutting-edge battery technology for electric cars. Although ElectricCo has not produced electric cars in a mass market, the battery technology is tested and highly valued.

AutoCo and ElectricCo jointly formed JV to produce electric cars for the mass market. JV benefits from ElectricCo's proprietary technology and AutoCo's manufacturing expertise and access to credit markets and distribution channels.

JV is financed with 30 percent equity and 70 percent debt. When JV was formed, ElectricCo did not have access to sufficient cash at inception to fund its equity interest. To purchase its equity interest, ElectricCo received a loan from AutoCo. The debt financing was obtained in the form of a credit facility from a third-party bank. For the bank to provide debt to JV, it required that AutoCo guarantee the loan.

Required:

- Is JV a variable interest entity (VIE)?
- Which entity, if any, should consolidate JV?