

JOINT VENTURES

Overview

Joint ventures are a means by which companies and businesses undertake activities and projects jointly. They may be undertaken when a project is beyond the capacity of an individual company. They are particularly important in the cross border context and may provide opportunities for a company to enter into new markets and industries.

The terms of a joint venture are entirely a matter for agreement. There are a number of different means by which joint ventures are structured. If one or more business are based in different countries, it is usually desirable to form a new vehicle or company in the overseas jurisdiction.

The first choice to be made is whether or not a separate legal entity will be established as a vehicle for the joint venture. An alternative is to use another arrangement such as partnership or limited liability partnership. A further possibility is a purely contractual cooperation agreement.

Where a company is used, all trading activities, assets and liabilities relating to the venture are placed in a single vehicle or its subsidiary. Where there is no pooling of assets and the arrangement involves a sharing of revenue and costs, a contract may suffice.

JV Company

A joint venture company, as a separate legal entity can own and deal in its own assets and can sue and enter contracted in its own right. The ability for the joint venture shareholders to limit liability in respect of losses of the joint venture is a significant reason for choosing a company format.

The legal relationship of the participants will usually be governed by the Memorandum and Articles of Association of the Company and by a separate shareholders or Joint Venture Agreement. The Joint Venture Agreement will specify how the parties are to capitalise the company and what guarantees and assurances are to be made to third parties.

The agreement will set out the detailed arrangements in relation to the control and management of the joint venture. It will cover the division of powers between the board, management and shareholder and how control is exercised.

Directors are usually nominated to the board, by each of the participants. Directors are generally be obliged to act in good faith in the interests of the company. The Companies Act 2006 has modified the rules in relation to director's conflicts of interest, in a way which facilitates joint ventures.

A joint venture company will need to be considered in the context of its position in a participant's existing "group" structure and financial arrangements. It may have implications under existing bank obligations. Where a joint venture is treated as a subsidiary undertaking of one or more of the participant companies, this will have obligations and implications under taxation and accounting rules.

An important difference between a joint venture carried on through a company and a non-company structure is that profits of the former arise directly to the company and are distributed outwards to participants. This carries double taxation. In contrast profits of a non corporate medium such as a partnership will accrue directly to the participants with a single tax charge only.

The contribution of assets to a joint venture company will normally trigger tax liability for the participants. The tax consequences of funding a JV company with debt and the ability of the participant to obtain deduction for tax is important. A JV company may form part of a tax group so that consortium relief is available for losses. This allows losses to be transferred for set off against profits of participants.

JV Limited Liability Partnership

LLPs have become wide spread in England in recent years. An LLP is an entity with a legal identity separate from its members. It has capacity to do anything a person can do. Every member of an LLP is representative or "agent", but they will not bind the LLP where they are not authorised by it to act and a third party is aware of the lack of authority. As a separate legal entity, the LLP's members are not liable for the debts and obligations of the LLP to third parties.

LLPs like companies are subject to certain formalities in relation to how they carry on their business. They are required to file account with Companies House. An LLP must have at least two members. New members can only be admitted with the agreement of existing members. The law sets out the "default" rules in relation to management of an LLP. The parties are free to agree alternative mechanisms.

An LLP is taxed as a partnership under UK law, notwithstanding the fact that it is a separate legal entity. The individual members are therefore taxed in their own names directly for their proportion of profits. There is therefore a single level of taxation only.

The advantage of an LLP is that it combines separate legal entity limited liability for its members with the tax status of a partnership. This makes them attractive vehicles for certain types of joint ventures that would formally have chosen the partnership mechanism.

Limited Partnership

The Limited Liability Partners Act 1907 which is still in force in Ireland and the United Kingdom allows for a limited liability partnership in which there is a general partner with unlimited liability (which can be a limited liability company) and other limited liability partners. The limited partners cannot participate in the management of the partnership without losing their right to limited liability. Accordingly, this mechanism may only be suitable for undertakings where the participants are passive investors.

Standard Partnership

The partnership structure is infrequently adopted as the legal structure for a business venture by companies. Partnership may be appropriate where it is desirable that

parties have common direct interest in the underlying assets of the venture and direct unlimited liability to third parties is acceptable.

Co-operation Agreement

A co-operation agreement is an arrangement under which participants agree to associate as independent contractors. The rights and duties of the participants arise from the agreement and associated arrangements. The agreement will specify the scope of the venture, its obligations and the commitment of the parties.

Unlike the case with partnership, participants in a purely contractual arrangement are not necessarily responsible for the liabilities and obligations of the other parties to the joint venture. Each participant will be exposed to liabilities and claims which arise from his own activity which is assumed or for which it is vicariously liable under the joint venture arrangement.

A co-operation agreement may be suitable where the parties wish to avoid the formalities of integration of a corporate structure or partnership and the integration of the tax accounting and regulatory requirements which come with them. It may be appropriate in relation to property development, tenders for construction contracts, exploration and development projects and other projects where participants make different contributions.

REITS

The REIT, or Real Estate Investment Trust enables qualifying companies and groups to elect to be treated as REITs for accounting periods after 2007. The effect of becoming an REIT is that subject of certain conditions; the company will be exempt from UK corporation tax on profit and gains. There is an annual charge of 2% on the market value of properties. There are various conditions which must be met. The company must be a UK resident and have its ordinary shares listed on a recognised stock exchange. At least 75% of the assets must be investment property and the 75% of the profits must derive from property investments.

Miscellaneous

European Economic Interest Groups derive from European Law. They provide a European legal basis to carry out economic activity through in common. They are in effect subject to certain limitations, which limit their use as joint venture vehicles.

A European company can be formed under European Union Legislation. It is known as Societas Europea. It has not yet emerged as a proper form of joint venture structure. Reforms have been proposed at European Union level which may improve take up on the use of the SE.

Competition law must be considered in the context of a joint venture. The EC Merger Regulation applies to certain joint ventures which will have cross border implications in European countries. Domestic UK legislation joint venture exempts most Joint Venture from competition control.

It is common for parties to transfer their employees to the joint venture entity. This will raise implications under the Transfer of Undertaking Protection of Employment Regulation (TUPE). The employment rights will automatically transfer. Certain consultations will also be required. Issues will arise under pension arrangements for the employees of the joint venture.

Joint Venture Documentation

The main documents in a company joint venture arrangement are the Memorandum and Articles of Association of the JV Company and the joint venture's shareholders agreement. The agreement establishes the basic rights and obligations of the parties in relation to the joint venture. The matter is one for negotiation. Typically the agreement will provide for the following:

- The object and scope of the venture;.
- Capitalisation and finance;
- Composition of the board of directors and management arrangements;
- Distribution and sharing of profits and losses;
- Transferability of shares;
- Protection of the minority;
- Provisions for unwinding a deadlock in a 50/50;
- Provisions in relation to terminations;

- Restrictive covenants in relation to other businesses.

There would typically be agreements in relation to the purchase of existing assets and the transfer of employees. There may often be a management agreement in relation to the operation of the venture.

In the case of non corporate joint ventures the agreement between the party will be similar to the shareholders agreement with differences which reflect the absence of a separate legal entity.

This Guide is intended as an overview and broad outline of the matters covered in it. Its purpose is to inform and raise awareness. We are happy to offer specific legal advice on particular circumstances.

This Guide should not be relied on as a substitute for comprehensive legal advice with reference to the particular circumstances.

While we have taken due care in the preparation of this publication, we do not accept legal liability as a result of any reliance placed on anything in this Guide. The reader should rely only on specific legal or taxation advice.