A Guide to Joint Ventures in Ireland

DILLON EUSTACE

DUBLIN CORK BOSTON NEW YORK TOKYO

A GUIDE TO JOINT VENTURES IN IRELAND

Introduction

'Nothing ventured, nothing gained' – a bold statement perhaps in the context of the current economic climate. However, companies that strive to develop their business or undertake a review of their strategic business models may find themselves considering the merits of a joint venture. Competitors of today may prove to be the co-operators of tomorrow, as companies look to establish a more cost-efficient means of expanding the scope of their business activities. With the objective of expanding or diversifying a business accompanied by a reluctance to share the associated risks and costs of undertaking such a project, or for the purpose of facilitating a union of differing experience and expertise, a joint venture arrangement may be 'on the table'.

Whatever the rationale, a joint venture arrangement will most likely result in a loss of control and autonomy for the existing shareholders, thus underlining the importance of choosing the correct joint venture partner, identifying the most appropriate joint venture structure and giving full consideration to a number of related questions that may arise.

This paper provides a brief overview of the main issues that will generally need to be considered when establishing a joint venture in Ireland, with a particular emphasis on the most common joint venture structure adopted; the corporate joint venture. Additional considerations may need to be addressed depending on the context of a particular joint venture proposal, particularly where the joint venture parties are located or operating under different legal and tax regimes in different jurisdictions.

Where do you start?

A confidentiality or non-disclosure agreement should be entered into between the parties during preliminary discussions. Public announcement requirements and stock exchange obligations will need to be considered and satisfied if either of the parties is a publicly quoted company. Other material authorisations, consents, licences, terms of existing third party agreements and other conditions precedent may also have a bearing on the setting-up of a joint venture.

An appropriate legal structure (typically influenced by tax considerations), methods of funding, terms of commercial operations and an appropriate exit strategy will need to be determined.

Structure

The basic options to consider when structuring a joint venture are as follows:

- Limited liability company

The most common joint venture structure in Ireland is a corporate joint venture which involves the incorporation of a limited liability company to carry out the joint venture business. The use of a limited liability company structure ensures that liabilities of the joint venture remain separate from the joint venture parties. However, the company members may need to provide guarantees or other forms of assurance to third parties, unless the entity is creditworthy in its own right, in order to carry out the activities of the joint venture.

Each joint venture party will normally obtain a shareholding in such a limited liability company that corresponds to the level of the party's interest in the joint venture.

A limited liability company is typically subject to corporation tax and income tax on dividends paid to its members.

- Partnership (the Partnership Act 1890 and the Limited Partnerships Act 1907)

Unlike a limited liability company, a partnership is a tax transparent structure which is subject to one level of tax by means of income tax on the profits paid to partners.

The Partnership Act 1890 imposes particular duties on partners in connection with the conduct of business and also lays down rules which automatically apply, subject in most cases to any contrary provisions in the partnership agreement, such as those in relation to the termination and dissolution of the partnership and the settlement of its liabilities.

In such a partnership (which can be established between individuals and/or bodies corporate), each partner is deemed by the Partnership Act 1890 to be the agent of the other partners for the purposes of the business. Notwithstanding the terms of the partnership agreement and subject to limited exceptions, each partner is jointly liable without limit for the debts and obligations of the partnership and jointly and severally liable for the wrongful acts and omissions of his/her co-partners.

In contrast to the limited liability company, the unlimited liability factor and the absence of a distinct legal vehicle in which the assets and liabilities of the joint venture can be vested and which can raise finance (including creating security) for the joint venture operations, are disadvantageous. For these reasons, a partnership established pursuant to the Partnership Act 1890 may not be an appropriate legal structure for a joint venture.

A limited partnership ('LP') may be established pursuant to the Limited Partnerships Act 1907. An LP must consist of at least one general partner and one limited partner, whereby the general partner has unlimited liability and the liability of the limited partner is limited to the amount of the capital contribution made by such a limited partner. In exchange for the statutory benefit of limited liability, the limited partner forsakes the right to partake in the management of the LP. It is also worth noting that a general partner may be a limited liability company thus effectively limiting the liability of the general partner.

An LP must be registered in the Companies Registration Office and is considered established upon the date of issue of the certificate of registration.

A carefully drafted partnership agreement is of fundamental importance to such a joint venture structure.

- Commercial alliance

A form of commercial alliance by means of a contractual arrangement between the joint venture parties may be the preferred joint venture structure in some circumstances. A contractual alliance is effectively transparent for tax and accounting purposes and each party will be taxed separately in respect of its participation in the joint venture. A commercial alliance is therefore often considered to be an attractive structure to those parties that are keen to have direct interests in the relevant assets and revenues associated with the joint venture, in order to satisfy particular tax, accounting and finance or regulatory requirements.

In such a contractual arrangement, an agreement will be entered into by the parties which will provide for the rights, duties and apportionment of liabilities of the parties, the term of their legal relationship, and other details specific to the scope of the joint venture. It is important to emphasise that each party is responsible for the activities of the other party to the contractual arrangement to the extent that such responsibility is not limited by the terms or indemnities provided for in the agreement. It also common practice for an agreement to expressly provide that it is the intention of the parties not to create a partnership and that each party to the agreement acts for his own account as principal and, except where otherwise specified in the agreement, has no authority to bind the other party.

Transfer of Assets

It is often the case that one or more of the joint venture parties will transfer particular assets to the joint venture company. Such assets may include land and buildings, fixtures and fittings, contracts, intellectual property rights or an existing business and should be identified at an early stage.

These assets will need to be valued to ensure that the value of each joint venture party's investment in the joint venture reflects the shareholdings of the parties in the joint venture company. It is prudent to carry out a due diligence exercise in respect of the assets to be transferred (to at the very least ensure the relevant party has title to the relevant asset) and in addition, it is normally advisable to obtain a suite of appropriate warranties from the transferring party in respect of the asset(s).

Tax

Tax considerations and planning are of fundamental significance when structuring a joint venture. The joint venture parties should consider if there are any capital gains on the transfer of assets/shares to the joint venture, if capital allowances or balancing charges apply in respect of the transfer of assets, and whether or not tax losses will need to be transferred. In respect of borrowings obtained to finance a joint venture, it may be possible to set interest payments against the profits of the joint venture company. Repatriation of profits, thin capitalisation rules and transfer rules may also be relevant in the context of international joint ventures.

Funding

The most typical initial funding methods in respect of a joint venture are as follows:

- Cash subscription for shares

  The joint venture parties will need to determine the amount of cash to be subscribed and the percentage interest in the share capital of the joint venture company to be obtained by each subscriber. The parties must also decide if any special rights will attach to these shares.

- Loans from joint venture parties

  A loan may be an appropriate source of funding. The interest paid on the loan may be deductable for the joint venture company for tax purposes. The term of the loan, the rate of interest payable, and the security to be provided (if any) will need to be agreed.

- Borrowings from third parties

  When considering the terms of the loan offered by a third party, it is important to consider if the joint venture company has assets that can act as security. In addition, in the event that the joint venture parties are called upon to guarantee the borrowing obligations of the joint venture company, the extent to which each of the joint venture parties will be liable will need to be determined.

If possible, the joint venture parties should also commit to appropriate obligations relating to any future funding arrangements.

Commercial Operations

The joint venture parties will need to agree on the manner in which the joint venture shall operate and identify the extent of their respective obligations, potential liabilities, commitments and entitlements during and after the life of the joint venture.

It may be the case that joint venture parties have certain obligations with regard to the future funding of the joint venture company. Terms and levels of funding should be agreed, including provisions that apply in the event of a default of payment of future funds. Terms to provide for funding obligations that are conditional upon certain target or performance related criteria may be appropriate.

Most joint venture parties will try to obtain as much control as possible in the joint venture company in order to protect their investment. Such control is typically derived through the appointment by each joint venture party of directors to the board of the joint venture company and by having certain rights of veto regarding material activities of the joint venture company (e.g. borrowings, certain contracts, disposal of assets, allotment of shares, issuing of guarantees or indemnities, dividend distributions etc).

Notwithstanding the nature of the relationship of the parties to the joint venture, the possibility of a disagreement between them should always be catered for. Having unequal voting rights may satisfactorily address such an issue, however, in a 50:50 joint venture a ‘deadlock’ may arise. An appropriate deadlock resolving mechanism (such as the Chairman of the board having a casting vote, arbitration or liquidation) should be agreed upon in advance of commencing the operations of the joint venture.

Exit Strategy

Many joint ventures are established to achieve a particular objective or for a limited period of time and therefore in such circumstances an agreement as to the manner in which the joint venture company can be closed down can be easily reached at an early stage. However, should the term of the joint venture be indefinite it will be necessary to determine the procedure that should be followed should a joint venture party seek to dispose of some or all of its shares. Typically, an agreement will be reached to the effect that the transferor of the shares will offer their shares to the other joint venture party first or for the latter party to block a transfer of shares to a third party purchaser unless it is agreed that the purchaser acquires all of the other shares in the joint venture company.

Other points to consider

- Regulatory Issues

  It is necessary to consider if any regulatory consents or filings are required in order to proceed with a joint venture. Such regulatory approvals are normally documented as conditions precedent to the establishment of a joint venture.

  It is important to highlight the potential applicability of Council Regulation 139/2004 (‘the EU Merger Regulation’) or Part 3 of the Competition Act 2002 (‘the Irish Merger Rules’) in the context of a joint venture arrangement. The establishment of a joint venture, if it involves the creation of an economic entity performing on a lasting basis all the functions of autonomous legal entity shall constitute a ‘concentration’ under the EU Merger Regulation and the Irish Merger Rules. Where a ‘concentration’ satisfies the relevant financial thresholds of the EU Merger Regulation or the Irish Merger Rules, it must be notified to the relevant competent authority (i.e. either the European Commission under the EU Merger Regulation or the Competition Authority under the Irish Merger Rules).

- Employees

  Employment law issues will need to be addressed when embarking on a joint venture. The European Communities (Protection of Employees on Transfer of Undertakings) Regulations 2003 will apply when the establishment of the joint venture involves the transfer of an existing business. The employees of the existing business may be employed by the joint venture company or merely seconded to the joint venture company. A harmonisation of employment terms and conditions of the parties to the joint venture may also be considered appropriate. The joint venture parties may opt to set up a new pension scheme for the joint venture – it is important that the pension rights and entitlements of the employees under existing pension scheme (s) are taken into account.

- Intellectual Property

  The intellectual property rights (e.g. in trade marks, software programs and designs) of the joint venture parties will need to identified at the outset. An agreement should be reached as to whether or not certain intellectual property rights should be transferred or licensed to the joint venture for its use.

Conclusion

Notwithstanding the commercial aspects and objectives of each specific joint venture, it is fundamental that the appropriate legal/tax structure is put in place in order to achieve your goals. The joint venture structure should be flexible enough to facilitate your requirements which may change as the joint venture evolves, while still ensuring that maximum protection of your investment is achieved.

Date: **February 2010**
Author: **Andrew Lawless**

DILLON EUSTACE

CONTACT US

Our Offices

Dublin
33 Sir John Rogerson's Quay,
Dublin 2,
Ireland.
Tel: +353 1 667 0022
Fax.: +353 1 667 0042

Cork
8 Webworks Cork,
Eglinton Street,
Cork, Ireland.
Tel: +353 21 425 0630
Fax: +353 21 425 0632

Boston
26th Floor,
225 Franklin Street,
Boston, MA 02110,
United States of America.
Tel: +1 617 217 2866
Fax: +1 617 217 2566

New York
245 Park Avenue
39th Floor
New York, NY 10167
United States
Tel: +1 212 792 4166
Fax: +1 212 792 4167

Tokyo
12th Floor,
Yurakucho Itocia Building
2-7-1 Yurakucho, Chiyoda-ku
Tokyo 100-0006, Japan
Tel: +813 6860 4885
Fax: +813 6860 4501

e-mail: enquiries@dilloneustace.ie
website: www.dilloneustace.ie

Contact Points

For more details on how we can help you, to request copies of most recent newsletters, briefings or articles, or simply to be included on our mailing list going forward, please contact any of the team members below.

Lorcan Tiernan
e-mail: lorcan.tiernan@dilloneustace.ie
Tel : +353 1 667 0022
Fax: + 353 1 667 0042

DILLON EUSTACE

DUBLIN CORK BOSTON NEW YORK TOKYO

33 Sir John Rogerson's Quay, Dublin 2, Ireland.
www.dilloneustace.ie

In alliance with Arendt & Medernach