

THE MOVEMENT OF LEGAL ENTITIES: JOINT VENTURES

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Abstract in original language:

Příspěvek kriticky hodnotí snahu Evropské Unie na poli poskytování služeb v zahraničí a vysílání zaměstnanců. Všímá si fatických problémů, na které osoby vysílající zaměstnance do zahraničí pravděpodobně narazí. Současně nabízí jako možné řešení spolupráci s místním partnerem na bázi Joint Ventures nebo strategické aliance. Vedle těchto možností hodnotí i další možné způsoby spolupráce a místními partnery a hodnotí jejich výhody a nevýhody.

Key words in original language:

Vysílání zaměstnanců; Joint Ventures; strategická aliance; spolupráce.

Abstract:

The paper focuses on the providing services abroad and on the posting of workers. It analysis the practical problems the legal entities might force when posting workers abroad. The paper supposes to solve these problems by cooperation with a local partner based on the Joint Venture or Strategic Alliance. It also outlines the other forms of possible cooperation and evaluates the advantages and disadvantages of this cooperation.

Key words:

Posting of workers; Joint Ventures; Strategic Alliance; Cooperation.

The movement of legal entities, posting of workers and providing services abroad is a big challenge. The legislation of the European Union shall enable these challenges and make the movement as easy as possible. In fact is the movement of legal persons, in contrary to the movement of natural persons, and despite the effort of the European Union not really successful. This paper presents some of the reasons why the movement of legal entities is so complicated and suggests possible solution – Joint Venture structures.

1. SINGLE MARKET LEGISLATION FOR SERVICES:

The movement of legal entities represents a significant part of the internal market, to be more exact of “single market legislation for services¹” of the European Union. The aim of the single market legislation is to enable an effective and simple movement of legal entities. The directives of European Union (hereinafter referred as “EU”) are directed into three core areas: Posting of workers², providing of services³ and recognition of qualification⁴.

¹ Compare the web site of the European Union: <http://europa.eu/scadplus/leg/en/s70002.htm>, date: 10. 5. 2009

² Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services

³ Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market

These directives were supposed to simplify the process of providing services abroad. The aim of the directives was also to unify at least some of the national requirements the foreign companies must comply with when working abroad, and to improve access to information concerning these requirements. We shall admit that because of the effort of the EU, it is today easier to find out basic information concerning the posting of workers, requirements we have to comply with and documents we have to prepare for posting of workers and providing services abroad. There are tons of books available on the topic of posting of workers or working abroad. However, do NOT try to solve real and concrete problem! Otherwise, you are getting into troubles, having almost no chance to answer your client's questions. Notwithstanding the effort of the European Union and all the additional activities, the movement of legal entities is not working and the companies are not encouraged to move.

PRACTICAL PROBLEMS OVERVIEW

Here are some of the problems you will probably face when posting workers abroad:

- The central core of mandatory protective legislation laid down in the Member State in which the work is carried out must be guaranteed to the posted workers. Nevertheless, it is almost impossible to find out what's the mandatory protective legislation which must be respected. Also the interpretation and the discovery of implied boundaries between terms used in the statutes is an unimaginable problem. E.g. In German Arbeitnehmerentendegesetz is stipulated, that the posted workers must be given the "Mindestentgeltsätze" – the minimum wages. There is a number of problems resulting out of this requirement. E.g. In Germany the minimum wages are settled only in selected areas. Therefore, first of all you have to discover, which areas are selected and which kinds of works belongs into this areas, and then the exact wages. In case your activity doesn't fall into the selected areas, there is another problem: Does the fact that the wages are not exactly stipulated by laws means that you may offer you employees whatever you want? Or does it mean that you still have follow the obligation following from the Art. 2 of Arbeitnehmerentendegesetz and to provide the employees with appropriate wages?
- In case the working conditions in state of origin are more advantageous for the worker, the employer shall provide the workers with the more suitable conditions. In many cases it is difficult to evaluate which of the legislations (state of the origin or the state of the posting) is more convenient for the worker. Therefore, the company may be never sure whether comply with the legal requirements. For example: Breaks during the working hours. In case the laws of the state of origin provides the works with one longer break (e.g. 30 minutes) and the laws of the other state with two shorter (2 x 15 minutes), which of the regulations is more advantageous for the worker?
- Posting workers and providing services abroad means collecting tons of documents (usually verified copies) and getting tons of approvals. This requires angelic patience and advanced detective skills. Do not rely on the web sites of local authorities. Do not rely of the authorities themselves. They know only general information and are usually

⁴ Directive 2005/36/EC of the European Parliament and of the Council of 7 September 2005 on the recognition of professional qualifications

not in the position to solve a specific or border cases. It is only up to you to discover which documents you need.

- What's really necessary is to provide the services in compliance with the local legislation. This implies to know exactly the local legislation. Not only that that foreign company has no idea about the local law, its structure, and which norms are applicable, but it even don't know where to start searching for the statutes, not speaking about the case law and interpretation of law provisions.
- You also have to discover the practise of the local authorities which must be taken into account. This is time consuming and very difficult. Nevertheless, not keeping with this practise may result in a fatal failure, high fines etc.
- Recognition of professional qualifications should be guaranteed if there are no substantial differences between the training acquired by the person concerned and the training required in the host Member State. However, the member stated may still require a compensation measure (exams or adaptation period of a maximum of three years). In case the last version of the EC directives were not implemented in the national law (like e.g. in Austria) or in case of hostile approach against the foreign companies, the national law will be interpreted in such a way that the foreign company must prove the qualifications requirements and pass exams requested by the local authorities (despite the fact that in accordance with the new version of the EC directives the qualification achieved in the country of origin must be sufficient). Would you be able to pass a mining exam and to prove your detailed knowledge of Austrian mining law in German language?

Still keen on moving?

2. POSSIBLE SOLUTIONS:

There are possible approaches which may help the companies to move and minimize the above mentioned problems. The connected link between all of them is the participation of another subject, usually local one. The financial intensity, relation between the local and foreign partner, the extent of involvement of the local partner into the project, personal engagement of the local partner and responsibility of the local partner are the core differences between the approaches. First of all the possibility of hiring a local attorney office or consultancy company, local accountant will be discussed. Then, the cooperation with a local partner, its advantages and disadvantages will be mentioned. Finally, the kinds of cooper will be presented: Simple contracts, Strategic Alliance, and Joint Ventures.

A. LOCAL ATTORNEY OFFICE OR CONSULTANCY COMPANY, LOCAL ACCOUNTER

Finding a local attorney seems to be a great idea, nevertheless, in case you are dealing with a special area of business (e.g. special kind of constructions, drilling works or drilling of wells, purchase of special products), it is very difficult to find out any attorney who is expert in this area. Working in such narrow area requires you to have a legal counsellor (e.g. company lawyer) who knows all particular details of your business. Nevertheless, your legal counsellor is well oriented only in the national law and legal counsellors from abroad are either working for your competitors or not available at all. Therefore, you have no other chance than to rely on local attorney.

The disadvantages of working with local attorney who is not specialized in your area of business are plain enough: Either paying for learning his or her learning or getting confusing information. Moreover, as a newcomer in new market and legislation environment, it is difficult to formulate your questions properly in such a way to tell to the attorney exactly which information you need. Therefore, there is high possibility that the information you received will be unuseful and won't provide with the answers you are searching for. This approach is expensive, time consuming and you can never be sure that the received information are correct and accurate.

B. COOPERATION WITH A LOCAL PARTNER

Cooperation with a local partner is another possible approach. It means that you will find a suitable partner for you goals, somebody who may contribute to your objective and help you to achieve your business plans. Each foreign market offers unique opportunities and risk and it is easier to face them together with a partner who may assist in entering there. The foreign partner can provide the other party with access to resources and skills that are unavailable to without local assistance at reasonable costs.⁵

Here is a brief overview of advantages and disadvantages of cooperating with local partner. This overview is focused firstly on the pros and coins of joint progress in Europe at the common market, thus all positives and negatives of working with local partner in developing countries are left out. Secondly, this overview concentrates on Joint Ventures cooperation.

ADVANTAGES OF COOPERATION WITH LOCAL PARTNER⁶:

Orientation in local rules and languages: Despite the fact that your exact choice of the local partner depends on your business plans and objectives, there is a high chance that a local partner will be well orientated in the local rules, familiar with legal requirements is able to speak the local language. Moreover, he knows the local customs and knows how to deal with the local authorities. Additional, as you have selected you partner according to your business goals and discussed the details of the possible cooperation, the local partner will understand the core business problems and is in the best position to assist you to get any approval from the local authorities. The local partner will also be able to provide you with legal advice or to help you to find an attorney or a legal counsellor who is specialized in your area of business.

Getting out of the competitors: "If you can't beat 'em, join 'em. Two heads are better than one. United we stand"⁷. Cooperating with your competitors or with your local contracting partner on a closer basis than the contractual one means to get support for joint project. The local partner will more likely provide you with important information and advises because both of you are following the same objective(s). You are in the same boat.

⁵ Gutterman, A., International Joint Ventures. USA: World Trade Press, p. 3.

⁶ Ibidem

⁷ Orsoni-Vauthey, V., Happy About Joint Venturing. [cited 22. 5. 2008]. Available at: <http://entrepreneurs.about.com/od/beyondstartup/a/jointventures.htm>

Financial resources can be shared: One of the most well known advantages of Joint Ventures (hereinafter referred as “JV”) is the opportunity to reduce the amount of capital needed to start business abroad.

Reduction of Business risk: JV enables not only costs reduction but allows also for investments diversification among different countries, industries and areas. Thus, the investors are obviously protected more than when approaching on the sole basis.

Control over the activities: JV structure allows to control directly the business conducted abroad and/or to manage the activities together with the local partner. Moreover, it enables the parties to learn from each other, to exchange knowledge and to improve their own skills.

DISADVANTAGES OF COOPERATION WITH LOCAL PARTNER:

The choice of JV partner is decisive: The Company who is intended to work abroad on JV basis face the problem of finding a suitable local partner sharing the same goals and objective, necessary knowledge, ability and willingness of the other party. The skills, ability and willingness of the local partner to perform its obligations during the term of JV seem to be decisive for the success of JV.

JV profits are shared: This is a well known fact. The profits of JV are distributed either in accordance with the contributions of the parties or with the agreement of the parties. The most common problem is how to value intangible assets and contributions, such as intellectual property rights or technical knowhow, management skills. Because it is almost impossible to value them, the parties may disagree on their portion to the JV contribution and therefore on their portion of JV profits.

Shared skills and technologies might be used outside of the JV as well: The parties are sharing the knowledge and technologies and contribution to the joint project. The disadvantage is that the gained skills will be most probably used in the sole project of JV partners as well. This seems to be quite common practice.

Local management styles may significantly differ: This can lead to many misunderstandings, conflicts and losses of motivation to work for JV.

It follows from this brief overview that despite the possible problems it is still easier and cheaper to cooperate with a local partner and to take the advantage of his or her orientation in local market, knowledge of local authorities, laws and regulations, local risks and dangers. As far as the posting of workers is concerned, one of the most important advantages is the knowledge of the local laws and regulations, especially the acquaintance of the mandatory protective legislative and conditions of work and employment.

C. THE MOST COMMON FORMS OF COOPERATION WITH LOCAL PARTNER:

This part of the paper shall discuss following kinds of cooperation, except the last one.

- Simple contracts
- Strategic Alliance
- Joint Ventures

- Mergers and Acquisitions⁸

SIMPLE CONTRACTS

(customer supplier, service contract, distribution contract, sub-contractors position).

Negotiating contract is the simplest form of cooperation with local partner. It does not require transfer of assets and control so that the parties to the contract remain completely autonomous. The contracting parties only agree on mutual rights and duties without creating joint entity.

The contracting parties have to follow the covenants stipulated in the contract and fulfil the contractual duties. The problems is that it is the sole responsibility of each contracting party to comply with the agreement and that the contracting party cannot in reality fully rely on the support of the other party. The simple contracts usually contain provisions like:

“Contractor shall be responsible for obtaining all necessary permits and authorisations in connection with carrying out the Work by Contractor, unless otherwise required by the legislation of the respective country.”

or

“Contractor shall comply and safeguard compliance of its subcontractors' with all applicable laws, rules and regulations in performing the Work hereunder, and such other regulations as are set forth in this Agreement and any attached Appendices, in particular, but not limited to, health, safety and environment.”

Therefore, in conformity with the contract is exclusively up to the contractor to take care of all permissions and to comply with all applicable laws and regulations. It is not responsibility of the other contracting party to notify the contractor about the applicable laws, authorities with is in charge of his or her duties etc. Help yourself and good luck!

For the reasons stated in the previous paragraphs is clear that simple contract is kind of cooperation with foreign partner, nevertheless it is not a cooperation including joint purpose, objectives, joint approach and support or even joint entity, nor offering the mentioned advantages of cooperation. From the point of view of posting of workers it is the most problematic and difficult kind of cooperation.

STRATEGIC ALLIANCE (HEREINAFTER REFERRED AS “SA”)

SA is more sophisticated form of cooperation with the foreign partner. A Strategic Alliance is a formal relationship between two or more parties to pursue a set of agreed upon goals or to meet a critical business need while remaining independent organizations.⁹ SA is often called

⁸ (M&A) are another form of cooperation. Nevertheless, because of the complexity of this issue and of its particular characters, won't be discussed in this paper.

⁹ Wikipedia: Strategic Alliance, [cited 22. 5. 2008]. Available at: http://en.wikipedia.org/wiki/Strategic_alliance

as “contractual Joint ventures”. In contrast to the Joint Ventures, the partners do NOT create a separate and independent legal entity.

SA involves contribution of assets and capital, but the mutual task is achieved inside the partner’s firms, not inside the JV Company.¹⁰ The parties agree on cooperative effort in which they contribute to the operations and services for a specified time to achieve technical, manufacturing or sales objectives. However, it is necessary to point out that the parties retain separate ownership of their assets and resources.¹¹

Strategic alliances allow members to cooperate in flexible and inexpensive way. Also the transaction costs are lower because the joint company needn’t to be established and managed. Besides these positives, the advantages of strategic alliance¹² includes 1) allowing each partner to concentrate on activities that best match their capabilities, 2) learning from partners & developing competences that may be more widely exploited elsewhere, 3) adequacy a suitability of the resources & competencies of an organization for it to survive.

Focusing on posting of workers, it is necessary to highlight that SAs are created on contractual basis. As the contracting parties have established the joint purpose of their cooperation, objectives and as they have decided to proceed together to achieve the objectives and to grow, they are willing to support each other and to help each other. Therefore, the contracting parties may agree on lawyering assistance and helping to get all permits. The local party can deal on behalf of the foreign with local authorities. SA seems to be an effective way out of the maze of legal requirements.

In contrary to the named advantages, SA as “contract plus” are usually not a suitable form of cooperation for achieving other advantages of classical Joint Ventures, like financial reductions, tax advantage or direct control over the joint activity.

JOINT VENTURES

JV is defined as cooperative business activity, formed by two or more separate partners for strategic purposes, which create an independent business entity, and allocates ownership, operational responsibilities and financial risks and rewards to each member, while preserving each member member’s identity/autonomy.¹³

JVs are considered to be the most powerful tools for being successful in today's competitive business atmosphere.¹⁴ The JV structure may improve the access to financial resources as well

¹⁰ Moskalev, S., A., Swensen, B., R., Joint Ventures Around the Globe from 1990-2000, p. 11. [cited 22. 5. 2008]. Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=878210

¹¹ Gutterman, A., International Joint Ventures. USA: World Trade Press, p. 10.

¹² Wikipedia: Strategic Alliance, [cited 22. 5. 2008]. Available at: http://en.wikipedia.org/wiki/Strategic_alliance

¹³ Moskalev, S., A., Swensen, B., R., Joint Ventures Around the Globe from 1990-2000, p. 11. [cited 22. 5. 2008]. Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=878210

¹⁴ Orsoni-Vauthey, V., Happy About Joint Venturing. [cited 22. 5. 2008]. Available at: <http://entrepreneurs.about.com/od/beyondstartup/a/jointventures.htm>

as the access to new technologies, customers and to innovative managerial practices. JV structures usually create stronger competitive units, because they are based on companies' strengths and supported by distribution of costs and risks.

*The essential elements of JV are:*¹⁵

- Contractual Agreement
- Specific limited purpose and duration
- Joint property interest
- Common financial and intangible goals and objectives
- Shared profits, losses, management and control

The process of partnering is a well-known, time-tested principle. The critical aspect of a JV does not lie in the process itself but in its execution and preparation. As about 60% of JV fail within five years, it is necessary to think carefully about the objectives, contributions, structure, and management etc. in advance.¹⁶

JV agreement:

The JV should be covered in a legal agreement which will be negotiated with ready, willing and able partner. JV agreement is key operational document which sets for a number of matters the parties have to agree on, e.g. objectives, duration, initial capitalization, additional financing, management, control, business and operational activities, allocation and distribution of income, sharing of losses, warranties, confidentiality clause and the termination of JV, resolution of disputes and the law governing the JV contract as well as the future activities. Because each of the partners will contribute various resources and skills to the new enterprise, including among others products, cash, personnel, facilities, raw materials, and marketing expertise, the contract has to specify these contributions and their value. The value of the parties' contributions usually determines the number of shares (if a corporate form is used) the parties are provided by. The number of shares generally predestines the right of the parties with respect to voting rights and the distribution of profits. However, the parties may agree on another arrangement for voting rights and profits allocation.¹⁷ This might be the case if the contributions include intangible assets or kinds of contributions where it is difficult to define the exact value.

The parties have also to think about the formation and structure of the new business entity (e.g. corporation, limited partnership, limited liability company etc.) and prepare all charter documents and decide how will take care of specified statutory filing and publication requirements.

¹⁵ Gutterman, A., International Joint Ventures. USA: World Trade Press, p. 2.

¹⁶ Ibidem

¹⁷ Ibidem

Besides the core JV agreement the contracting parties usually negotiate a number of partial agreements between them and the JV. Based on these agreements the partners are supposed to provide the JV with services, goods, and other supplies or to enable the JV to use the assets (e.g. machines, buildings, licences) and to function as a real company.

Structure of JV:

The phrase „Joint Venture“ generally refers to the purpose of the entity and not to a type of entity. Therefore, the factual structure of JV may defer from case to case, depending the number of partners involved in JV, interests, expectation and experience of these partners, countries involved, and objectives of JV etc.

In case the contracting parties decide to create not only contractual JV, but separate legal entity, the parties gain a number of advantages. New legal entity created for special purpose and definite period of time is known as *Special Purpose Vehicle* (hereinafter referred as “SPV”) or a special purpose entity (SPE). It is a legal entity created by a firm (known as the sponsor or originator) by transferring assets to the SPV, to carry out some specific purpose or circumscribed activity, or a series of such transactions. SPVs have no purpose other than the transaction(s) for which they were created, and they can make no substantive decisions; the rules governing them are set down in advance and carefully circumscribe their activities.¹⁸

SPE's are typically used by companies to isolate the firm from financial risk. A company will transfer assets to the SPE for management or use the SPE to finance a large project thereby achieving a narrow set of goals without putting the entire firm at risk. The assets or activities are distanced from the parent company; hence the performance of the new entity will not be affected by the ups and downs of the originating entity and vice versa. The SPE will be subject to fewer risks and thus provide greater comfort to the investors. What is important here is the distance between the sponsoring company or companies and the SPV. In the absence of adequate distance between the sponsor and the new entity, the latter will not be an SPE but only a subsidiary company.¹⁹ Based on this distance, SPVs are carefully designed to avoid bankruptcy and reduce bankruptcy costs.

Some reasons for creating SPV:

- Risk sharing: Companies may use SPEs to legally isolate a high risk project/asset from the parent company and to allow other investors to take a share of the risk.
- Financial engineering: SPEs are often used in complex financial engineering schemes which have, as their main goal, the avoidance of tax or the manipulation of financial statements.

¹⁸ Gorton, G., Souleles, N., S., Special Purpose Vehicles and Securitization. [cited 22. 5. 2008]. Available at: <http://knowledge.wharton.upenn.edu/papers/1314.pdf>

¹⁹ Wikipedia: Special Purpose Entity, [cited 22. 5. 2008]. Available at: http://en.wikipedia.org/wiki/Special_purpose_vehicle

- Limitation of liability: The companies will transfer only the necessary part of their assets to the SPV. Therefore, the companies or investors retain full control over the assets which get into risk and be victimized.²⁰

SUMMARY:

The posting of workers and the possibility the extent the scope of our activities abroad is a big challenge. However, despite the whole effort the European legislators, the legislative of the EU is not able to make the movement of legal persons easier. The legal requirements posed on the companies are not easy to comply with. It takes a lot of time and effort to find out the laws not speaking about their interpretation. There are usually no authorizes with jurisdiction to provide the companies with binding interpretation of the legal norms. It is almost impossible to discover very specific information, despite the fact that the answers might be decisive for the decision whether move or not. Based on the mentioned factors it is very risky to move. The companies are facing not only significant fines but also lost of good reputation which may be even worse. One of the possible solutions is to find a local partner and to cooperate closely with him or her. This solution (either in the form of contractual JV or JV with separate entity) seems to be more effective that the cooperation based on the simple contract.

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