Top ten considerations when terminating a corporate joint venture

The enthusiasm and shared commercial goals which brought joint venture parties together to form a corporate joint venture can dissipate for a variety of reasons. This will inevitably lead to parties considering their options which may include the termination of the joint venture itself. Given that the consequences of termination can be severe it is critical that parties fully understand the potential consequences of termination prior to initiating such a process.

Key considerations when terminating a joint venture

We are often asked to advise clients on the key issues to consider when contemplating bringing a corporate joint venture to an end. In most instances, the joint venture entity will continue and one party will simply acquire the joint venture entity completely and go it alone as it will rarely be in the best interests of either party if the business of the joint venture is broken up and the assets liquidated or a sale forced upon the parties. Against that backdrop we have compiled the following list of top ten considerations.

1. Process for termination

The first matter to be considered is the process for termination which will, in most instances, be set out in the joint venture agreement between the joint venture parties and the joint venture entity itself. With termination processes flouting names that would not look out of place in a Vegas casino – Russian Roulette and Texas Shootout to name but two – early engagement of legal advisors is imperative to ensure the procedure is understood and, crucially, followed.

2. Risk profile

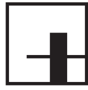
When termination of a joint venture occurs in circumstances where one party acquires the joint venture entity and continues the business alone, they do so with increased risk and will ultimately bear the sole risk of failure. A full and thorough risk assessment of the joint venture should be carried out and measures taken to de-risk the venture to a suitable level, which may entail seeking a new joint venture partner.

3. Experience

In addition to the spreading of risk, experience will be a key determinant in selecting a joint venture partner. A party seeking to terminate a joint venture by buying out its joint venture partner will need to assess whether it alone has the requisite knowledge and experience to achieve the objectives of the joint venture. This will be a material consideration where there is a shortage of expertise in the particular field.

4. Financial considerations

If, as part of the termination, one party will acquire the other joint venture party's interest then the acquirer should ensure that appropriate funding is in place for the purchase, which may require entering into the capital/debt markets or even securing a new partner. It is also important to understand the structure of any existing finance provided to the joint venture entity by the exiting party, since this will undoubtedly require to be dealt with as part of the exit. If the exiting party requires loans to the joint venture entity to be repaid, the remaining party should carefully consider its ability to refinance that debt. The outgoing partner may also have granted a guarantee in respect of the joint venture entity, which may also need to be replaced. It is also of critical importance that the on-going capital requirements of the joint venture are



understood to ensure termination does not result in a funding gap or otherwise have a detrimental impact on the covenant of the joint venture entity.

5. Change of control
The joint venture entity is likely to have entered into a number of key commercial contracts with suppliers and customers. These contracts may provide that they can be renegotiated or terminated if there is a change in control or ownership of the joint venture entity. These contracts should be identified prior to terminating the joint venture and appropriate consents obtained. Indeed, when negotiating such contacts, the definition of 'change of control' should exclude the situation where one of the joint venture participants simply acquires outright control.

6. Assets
The joint venture entity may make use of assets, such as intellectual property or IT systems, which are owned by an exiting party. Consideration should be given as to how the joint venture will operate without these assets or whether viable alternative possibilities exist, such as entering into separate licence or transfer agreements. If no reasonable alternatives exist then, as part of the exit, transitional arrangements will have to be put in place with the exiting party to ensure continued use for an appropriate run off period. Naturally these arrangements will come at a cost, which should be factored into the exit negotiations. The ownership of assets themselves will also require to be considered. For instance, how will intellectual property that is created by the joint venture entity using the pre-existing intellectual property of a joint venture partner be dealt with. The parties should be clear on how the exit will affect the allocation of on-going rights to the exploitation of the intellectual property created by the joint venture entity.

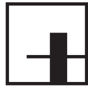
7. Goodwill
A well-drafted joint venture agreement will include controls on the use of confidential information shared for the purposes of the joint venture, as well as restrictive covenants which seek to protect the goodwill of the joint venture entity. These provisions are likely to continue beyond termination of the joint venture, so the parties must fully appreciate what they can and cannot do following termination.

8. Employees
Responsibility for staff employed by the joint venture entity, either permanently or on secondment, can be problematic. Seconded staff are likely to return to their original employer, which may leave the joint venture entity under resourced. The Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) may apply to automatically transfer joint venture employees contracts of employment to any party that takes over the joint venture business. In most cases, the TUPE transfer would be from the joint venture to a joint venture party. Alternatively, the joint venture parties may decide not to continue with the joint venture business, nor to integrate staff back into the parent businesses, and instead allow the joint venture operation to cease. In these circumstances, the costs and related effects of redundancies will need to be considered by the joint venture itself in respect of its own employees and by the joint venture parties in respect of the roles of any seconded individuals.

9. Pensions
Any pension arrangements which have been put in place for joint venture employees will merit consideration, particularly where the joint venture entity has been required to auto-enrol employees into a pension scheme in accordance with its statutory auto-enrolment requirements. Actions will depend on whether the staff will transfer to another employer or be made redundant and also on the nature of the arrangements in place. The joint venture entity may have set up its own pension arrangements or used those of a joint venture party. The nature of the benefits provided by the arrangement will be relevant. A defined benefit arrangement with a funding deficit could have significant cost implications.

10. Tax implications
Tax implications will be a major consideration in deciding which method of termination is most appropriate for a specific joint venture. For instance, if the joint venture entity is a limited liability company, the transfer of assets back to the joint venture parties on the winding up of the vehicle may give rise to a corporation tax charge (as well as stamp duty and VAT depending on the type of asset). Further, the sale of shares by a joint venture partner may qualify for Substantial Shareholding Exemption, but would otherwise result in a corporation tax charge. If the joint venture entity is a partnership, the transfer of assets back to the partners can give rise to capital gains tax charges. Other taxes can apply depending on the assets and circumstances involved.

Do your homework
As is evident from the above, the effect of termination on the business of a joint venture can be far reaching. Joint venture parties should consider the wide range of commercial, operational, legal and practical issues which could arise as a result of termination. Indeed, joint venture parties would be well advised to carry out thorough due diligence in advance of any termination to ensure, where the intention is to continue the business, that: (i) the joint



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venture is sustainable; (ii) the value of the joint venture business will not be materially eroded, and (iii) there are no unwanted surprises following termination.

For further information or advice on any of the issues discussed in this briefing note, please get in touch with Danny Lee or John Morrison

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