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# CROSS-BORDER INVESTMENTS, JOINT-VENTURES (JVS) AND THE BREXIT EFFECT UK-ITALY JVS, BY STEFANO MACCHI DI CELLERE AND ANDREA COVOLAN (MACCHI DI CELLERE GANGEMI)

The historic triggering of Article 50 of the Treaty on the Functioning of the European Union (TFEU) by the UK has now started a two-year long withdrawal process, after which it is expected that changes in UK laws might have an impact on foreign direct investment (FDI) in the UK, in particular affecting cross-border investments with EU Member States such as Italy.

## *FDI in the EU Single Market*

FDI includes setting up new branches abroad, enlarging existing establishments or taking-over local companies. Countries ceaselessly attempt to secure FDI, as a means to increase productiveness, wages, and improve and renew technological-managerial know-how.

The UK, with its stable and efficient rule of law, flexible labour market and highly-skilled workforce, has always constituted an attractive FDI destination. In the UK there is no particular restriction on FDI and from a legal standpoint foreign companies are treated as UK-owned businesses, allowed to engage in all the available kinds of economic activities.[i]

In such respect, Italy plays an important role in the UK FDI economy, having a great impact on its growth and innovation. Whilst the economic crisis has affected commercial exchanges since 2008, the economic relations between Italy and the UK are solid and diversified, growing every year.[ii]

According to the latest *Survey of the Italian investments in the UK* by the Italian Chamber of Commerce and Industry for the UK, a total of 695 Italian subsidiaries joined the UK market through different business strategies (Joint Ventures, Franchising, M&A, etc.).

Taking into account the variation over a 13-year period (from 2000 to 2013), the aggregate turnover of FDI generated by Italian investments in the UK has sharply increased by 273%.[iii]

## *THE BREXIT EFFECT*

Statistical data show FDIs have boosted productivity and economic growth in the EU economy. However, this upward trend could be seriously dampened by the advent of Brexit.

At least three arguments could be made as to why FDI might plunge when the UK leaves the EU:

- UK presence in the EU Single Market made it an attractive export platform for Non-EU multinationals, as they avoided incurring tariff barrier costs when they exported to other EU countries; this may no longer be the case;
- multinationals' complex supply chains and co-ordination costs between headquarters and local branches may become more difficult to manage; i.e., multinational components will be subject to more regulations and costs;
- uncertainty on the commercial arrangements between the UK and the EU could further cause a decline in FDI.[iv]

Eventually, even if the UK opts to become an EFTA member,[v] the limited advantages (such as, lower UK financial contribution; possibility to freely set UK VAT levels; and capability to ratify free-trade agreements faster), will not counterbalance the benefits deriving from the former status nor entice FDI.[vi]

Several legislative changes affecting FDI are expected to occur once the UK finally leaves the EU.

First and foremost, the UK's equity capital market will cease to be subject to EU legislation, and specific domestic regulation must be established as a replacement. Essentially, the UK will aim to streamline existing regulations, while removing undesired provisions. In particular, it will review capital market regulations enacted to implement EU directives.[vii] On the other hand, M&A will be subject to less EU regulations and will likely be less affected.

Additional factors will bring uncertainty to a number of legal parameters that foreign companies apply today in view of undertaking business activities in the UK:

- the UK might lose the benefits and privileges granted by the "Four Freedoms" (the elimination of tariffs on goods; freedom to sell goods and services in the EU; harmonised export rules; minimum regulatory and product standards), leading to the de-harmonisation of trading rules, potentially demanding businesses to deal with increasingly different legal systems;
- the UK might not be subject to EU competition law; even if many EU competition principles will survive in the UK Competition Act 1998 domestic legislation, these will be exclusively applied within domestic territory;
- in terms of indirect taxes on goods and services, the UK might no longer be subject to the VAT intra-community regime. Consequently it will not be able to enjoy the cross-border refund system under Directive 2008/9/CE, which enables businesses that incur VAT on expenditure in a Member State where they are not established, to recover the VAT directly from the relevant Member State;

- other implications will concern, *inter alia*, reduction of freedom of movement; change of terms and conditions of employee transfers; lesser protection for sales agents; divergence with EU laws on key cross-border areas, such as privacy and data protection, environment, and security.

### *Joint Ventures as an Alternative Means for Cross-Border Investments*

The UK has made its intentions clear that it will strive to seek the best possible results from negotiations with the EU, aiming to remain competitive in the European market.

However, given the inevitable change of rules, attracting cross-border investments through the means of cross-border Joint Venture vehicles could be the most effective and efficient measure available to investing entrepreneurs during the interim and short-term period.

Joint Venture (JV) is a term without a defined meaning under English and Italian law. It is usually used to refer to one or more arrangements where two or more parties collaborate to pursue a business activity.

In general terms, JVs involve two types of ventures:

- Contractual JVs, used when parties do not want to go beyond a mere relationship between themselves or when parties intend performing an activity on an occasional basis and within a limited time frame;
- Corporate JVs, used when incorporating a new company for the co-operation of two existing companies.

### *UK Joint Ventures*

In the UK there is no statutory law referring specifically to JVs and such a relationship between the parties could be subject to a combination of common law rules, substantive provisions of company or partnership law, tax law and competition law.

It is however important to point out that the main features of UK contractual JVs are:

- that these can be formed through different types of contracts such as agency agreements, distribution agreements, collaboration agreements, a franchise, a strategic alliance or an intellectual property license;
- that it is not compulsory to follow a formal procedure or registration with a local registry, nor to consult public officers, in order to establish a contractual JV;
- JV agreements may fall under: (i) Chapter I of the Competition Act 1998, which enables the Competition and Market Authority (CMA) to prohibit any covenant having the object or effect to

restrict competition in the UK market; it is possible to distinguish two types of restrictive covenants: a) *horizontal non-compete* covenants, made between two or more potential competitors at the same level of the production chain; b) *vertical non-compete* covenants, in which one party is a distributor, franchisee, licensee or agent of the other and serious competition concerns may arise if there is insufficient inter-band competition in the markets affected by the agreement; or (ii) Chapter II of the Competition Act 1998, which empowers the CMA to prohibit the abuse of dominant market positions in the UK;

- a contractual JV can be easily terminated by the parties in accordance with the termination provisions set out in the contract.

With regard to UK corporate JVs, the main points to underline are:

- the most common legal structure employed is the limited private company (Ltd) or limited private partnerships (LLP), or a general partnership, all of which must respectively comply with the Companies Act 2006, the Limited Liability Partnership Act 2000 and the Partnership Act 1980;
- the JV must be incorporated using the constitutional documents (Memorandum of Association and Articles of Association) in the English language, to be registered and accepted by the Companies House;
- a person can participate in the share capital of a Ltd JV, following the procedure set out by the Companies Act 2006, by contributing in cash, assets or intangibles; the same framework applies to LLPs or partnerships;
- with respect to governance, if a JV is constituted in a form of an Ltd, it must have at least one director (a natural person and over the age of 16);
- when a JV undertakes a merger, it may be subject to the UK Merger Control by CMA, which can investigate if a transaction has resulted in a lessening of competition and, as a consequence, might prohibit such transaction;
- corporate JVs can be usually terminated according to the provisions of the shareholders' agreement, which can provide, *inter alia*, the (i) acquisition by one party of the shares of the others; (ii) sale or realisation of the venture; and (iii) liquidation of the company.

*ITALIAN JOINT VENTURES*

English entrepreneurs and businesses interested in investing in the Italian markets following the UK exit from the EU, may on the other hand take advantage of Italian based JVs.

JVs are not specifically regulated under Italian law; in fact, the parties are able to form contractual and corporate JVs under the principle of freedom of contract, without any limits to the JV's duration and number of members.

JVs can be established with any commercial purpose and for any economic field, but they must comply with a particular regime or approval set out by public sector bodies when operating in certain markets (such as insurance, banking and telecommunications).

Italian contractual JVs have the following advantages:

- it is possible to freely establish agreements under Article 1322 of the Italian Civil Code, choosing the best type of contract in relation to the JV's business aim; the agreement can embody non-competition clauses defined in terms of time, territory and duration (not exceeding five years), as imposed by Article 2596 of the Italian Civil Code;
- there is no specific registry for contractual JVs, but deeds must be executed before a Notary public when involving the transfer of certain rights (such as real estate); the agreement can be drafted and executed in a foreign language, although for purposes of fiscal registration with the Italian Revenue Agency (*Agenzia delle Entrate)*, a sworn translation in the Italian language is required;
- JV contracts may be prohibited by the Italian Competition Authority (*Autorità Garante della Concorrenza e del Mercato,* AGCM) if they consist in restriction of competition freedom and are deemed to be: (i) anti-competitive agreements (*intese*); or (i) an abuse of the dominant market position (*abuso di posizione dominante*), under Articles 2 and 3 of Law No. 287 of 1990;
- JV contracts may be terminated with various mechanisms. Early termination could be accomplished only with cause, in accordance with Article 1372 of the Italian Civil Code.

With reference to Italian corporate JVs, it is worth highlighting:

- that the most common type of company chosen for corporate JVs is the joint stock company (*Società per Azioni*, S.p.A.*)* and the limited liability company (*Società a responsabilità limitata*, S.r.l.);
- that companies can be incorporated by drafting the deed of incorporation and the by-laws in Italian language certified by a Notary public and registered with the Companies' Registry (*Registro delle Imprese*) at the local Chamber of Commerce. Additionally, ancillary shareholders' agreements may be drafted and executed in the language chosen by the parties;
- the possibility to participate in the share capital by cash remittance or contributions-in-kind, in accordance with the company by-laws;

- the management of the company rests only upon the directors (or sole director), who are elected by the shareholders and must achieve the corporate purpose established in the company by-laws;
- if a JV undertakes a merger, it may be subject to Merger Control by AGCM, who can investigate if the transaction results in lesser competition, in which case it could prohibit it;
- a JV termination could be determined by: (i) the expiry of a term; (ii) the achievement of the corporate purpose; (iii) the impossibility to operate; or (vi) the protracted inactivity of the shareholders' meetings (termination is always followed by the liquidation of the corporate vehicle).

***Reverse Cross-Border Mergers***

The EU cross-border Directive provides for a special regime that allows mergers between companies incorporated in any EEA State.

Under The Companies (Cross-Border Mergers) Regulations 2007/2974, implementing EU Directive 2005/56/CE, a cross-border merger by absorption of a wholly-owned subsidiary consists in a company transferring its assets and liabilities to another company, which holds shares or securities representing its capital. A reverse cross-border merger, on the other hand, takes place where a parent company is absorbed and merged into its subsidiary.

Thanks to this peculiar type of merger, it is suggested that UK parent companies might be able to expand (and even transfer their headquarters) to EU countries by purchasing the relevant assets.

It is not by coincidence that recently, in January 2017, for the first time in the history of English legislation, the High Court approved a reverse cross-border merger between an English company, Formenta Ltd, absorbed by its Italian subsidiary, Newco Immobiliare Srl.

The High Court appreciated the applicant's internal restructuring motivations and confirmed a well-established principle of English law, that is, that courts cannot interfere with the administration of a company where the shareholders have validly expressed their will.

Before the Formenta decision, the above referred Regulations had never been applied to a reverse cross border merger under English law, even though it had been allowed under the equivalent Italian legislation.

Parent companies in the UK might consider adopting Regulation 2007/2974 while its applicability is still certain for the next two years - before completion of the Brexit process - by consolidating, acquiring or joint venturing with Italian partners, and thus gaining the related advantages and shoring up for Brexit.

To conclude, we believe that, in spite of Brexit, the UK is and will remain a place for suitable and attractive investment. Italian businesses aiming to start up enterprises in the UK, might take advantage of a contractual JV approach if they do not wish to commit themselves in a changing legal and regulatory environment. On the other hand, UK businesses wanting to expand outside the Union, might want to adopt a creative corporate structure, possibly partnering with an existing business that is already well established in the Italian market, and thus guarantee its legal entity direct access to the broader EU market.

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[i] After the US and China, the UK is the third recipient of FDI, about half of which comes from other EU Member States (according to UK Trade and Investment – UKTI 2015). Inward FDI has been holding an upward trend in the last decade; in particular, the UK receives an estimated stock value which has broadly doubled from £500,000 billion in 2005 up to £1,015.4 billion in 2014, with the EU as the largest source of investment in the last reference year (treating it as a single region), presenting an invested amount of £495.8 billion (49,7% of total UK inward investment). Outward FDI, on the other hand, has registered a slight decline in each single year since 2011, falling in 2014 to £1,015.4 billion (the downfall aligns with falling rates of return UK investors generate abroad, resulting in their disinvesting). Similarly to UK inward FDI, the largest destination for UK FDI was the EU (if considered as a single region), with a value of £404.2 billion in 2014 (39.8% of the total UK outward investment).

[ii] Office for National Statistics, International perspective on UK foreign direct investment (FDI): 2014.

[iii] The Italian Chamber of Commerce and Industry for the UK, The fifth Survey of the Italian investments in the UK, 2014.

[iv] Dhingram, Ottaviano, Sampson and Van Reenen, The impact of Brexit on foreign investment in the UK, Center for economic performance, London School of Economics and Political Science, 2016.

[v] The European Free Trade Association.

[vi] As a matter of fact, it would appear that there is no statistical difference in FDI outcomes between an EFTA and a non-EU member, such as the US, according to the Institute for Government, Brexit Brief: options for the UK's future trade relationship with the EU, 2016, [https://www.instituteforgovernment.org.uk/sites/default/files/publications/Brexit%20Options%20A3%20final.pdf] accessed 21 March 2017.

[vii] The Disclosure and Transparency Rules derived from the EU Transparency Directive.