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Joint Ventures Between Automotive Companies – The Future?

Due to the diversity of companies and industrial groups in the automotive sector, experiences of the recession have varied widely. While some companies have succumbed to the tough conditions, the headline-grabbing bailout of General Motors by the US government being the archetype, others have identified opportunities – and capitalised on them. In spite of the unpredictable nature of this particularly dynamic industry, a clear trend has emerged in recent years towards companies of all types forming joint ventures to spread the risk of new commercial strategies in these uncertain times. Setting up a traditional joint venture ('JV'), where a new entity is incorporated and the collaborating parties are stakeholders in the new entity, offers clear commercial advantages – namely, it creates formal legal relationships between the parties, affords certainty and isolates risk. However, alternative JV structures are available to businesses that offer varying degrees of integration between the parties and an assortment of tax advantages. This article explores the market conditions that are prompting companies to join forces and the legal considerations to bear in mind when embarking on a new JV.

New Technologies:

The increasing consumer appetite and regulatory requirements for vehicles that produce a smaller carbon footprint has spurred the development of new fuel technology, lighter materials and fuel efficiency solutions. Increasingly, companies are collaborating with their suppliers and competitors to achieve efficiencies that allow them to bring innovative technologies to the market at the lowest possible cost. For instance, Bosch, DEUTZ, an engine manufacturer, and Eberspächer, an exhaust system and component supplier, have together set up a JV for diesel exhaust after-treatment, which was approved by the European Commission (visit: http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/408) in April.

Emission control and fuel economy requirements vary dramatically from jurisdiction to jurisdiction, and, while progress towards harmonising those requirements to a universal international standard is slow, car manufacturers have to struggle with the complexities – and constantly update their product portfolios in an effort to keep up. Likewise, the broader regulatory landscape, for example the high tax imposed on fuel in Europe which, in turn, creates consumer demand for cars with smaller or diesel engines, exerts a meaningful influence on product specifications. In order to diversify their product portfolios, companies are investing in strategic growth areas, and spreading the risk inherent in all investment, by pairing up with other companies pursuing similar goals. The creation of JVs to deal with increased manufacturing costs, and to remain competitive in an increasing stringent global regulatory regime, is a commonly deployed tactic.

Car manufacturers are also gaining competitive advantage by teaming up with other businesses in foreign jurisdictions to capitalise on the government incentives available in those countries to produce cleaner technologies. A prime example is the funding put up last year by the US government, to the tune of $2.4 billion, for new ventures concerning automotive batteries and electric vehicles (visit: http://apps1.eere.energy.gov/news/daily.cfm/hp_news_id=159).

Opportunism in the Recession:

Some car manufacturers are seizing on the chance to grow their business and expand into new markets by capitalising on those distressed companies keen to shed their assets. While the most aggressive strategy to achieve this aim – acquiring distressed businesses that already occupy the target market niche – may also seem the most obvious, many companies both at home and abroad are instead seeking to strike joint venture deals with incumbent firms to avoid fuelling trade tensions.

The joint venture between Potenza Sports Cars (owner of Westfield Sportscars) and the Malaysian firm DRB-HICOM (which manufactures and distributes cars under well-known marques such as Audi, Mercedes Benz, Honda, Suzuki, Mitsubishi, Isuzu and Mahindra) is a recent example. The JV intends to produce and distribute a new eco-friendly and affordable sports car in Malaysia and across South East Asia with production starting in 2012 (visit: http://www.ukti.gov.uk/uktihome/media/localisation/117753.html).

In addition, the JV will export complete-knock-down kits and components manufactured in Malaysia to Potenza for the assembly at its UK plant for the European market.

The Legal Considerations:

Creating a joint venture that will focus on a specific goal, such as the development of a new technological solution, product specification or to infiltrate a foreign market, enables businesses to generate opportunities, pool resources and share risks. The key decision for the participating businesses to make is whether the new enterprise will be incorporated – in other words, whether the participants will establish and co-own a new company that is a separate legal entity distinct from its 'parents' – in order to carry on the business of the new venture.

The legal form the joint venture should take rest on factors as diverse as the size of the new enterprise, the location of the participants, their commercial and financial objectives, as well as tax and competition law considerations. While an incorporated structure is a tried and tested method that, in many jurisdictions, is underpinned by an established body of legal principles, it is a relatively permanent and formal structure that might not fit in with the participant's profiles and objectives. In an increasingly globalised industry where cross-border joint ventures are becoming common, the differences in legal systems between countries (such as common law jurisdictions like the UK civil law jurisdictions like France) can also prove problematic if not given due consideration at this stage.

Broadly speaking, the basic choices fall into two categories:

- Incorporated entities, such as limited liability companies and limited liability partnerships; and
- Unincorporated organisations, such as legal partnerships and consortiums.

Incorporated structures are advantageous because they allow the JV to own and deal in assets, bring actions and contract in its own right. Most significantly, the liability of the participants for the losses and liabilities of the joint venture is generally limited to the amount unpaid on the shares they hold. However, due to the JV's status as a separate entity, there may be unwelcome implications for the participants in terms of their financial and accounting arrangements, and potential for a large corporation tax bill in respect of transactions between the participants and the JV. Due to the disclosure obligations for companies registered in highly regulated jurisdictions, such as the UK, the activities of the JV will be subject to a level of public scrutiny that may be avoided if a more informal structure is used. Further, like the Bosch, DEUTZ and Eberspächer JV mentioned above, the new enterprise may fall foul of local or European competition rules and require clearance from the domestic competition authority, and/or the European Commission.

Legal partnerships are less commonly used as a structure for business ventures because they do not offer the practical advantages of limited liability partnerships or companies. Further, because each partner is deemed at law to be an agent of all other members of the partnership, each partner is jointly liable for the actions of the others. However, it may make sense to consider a partnership structure in situations where the participants wish to have a direct interest in the assets used and contracts formed in the business of the JV, or to achieve specific tax advantages.

More common, however, are simple co-operation agreements between participants. These have the effect of putting the participants' relationships with one another on a legal (specifically contractual) basis without the degree of integration mandated by an incorporated JV. There will be no direct tax implications for the participants, and corporation tax will simply be payable on the profit accruing to each participant directly. Unlike a partnership, the participants in a consortium formed by a co-operation agreement will not share the liabilities and obligations of the others, except to the extent provided for by the agreement. Normally, an express declaration denying any intention to create a partnership is included in the agreement as evidence to counter any subsequent inference that a partnership actually subsists (and that the participants should therefore share liability).

Conclusion:

While the conditions that make collaborating with suppliers and competitors an appealing option for players in the industry pervade, no doubt new joint ventures will continue to proliferate. The close interaction of suppliers and lead firms has been an important catalyst for the expansion of the industry, and especially in developing countries. This interaction has evidently created opportunities for relative newcomers to the automotive sector to move up the value chain and allowed incumbents to expand into new markets and to expand their product offerings at decreased cost and risk. In all cases, it is necessary to take the parties' objectives into account when deciding how best to structure the JV. Although a JV may not live or die by the legal form in which it is structured, those decisions may nevertheless severely impact the JV's profit margin and operational functions, or have unintended consequences of the participants, if not considered wisely first.

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