qLegal
The small print for BIG IDEAS

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Client Reference Number: **[Confidential]**

16th November 2021

Privileged & Confidential

By email to: **[Confidential]**

Dear **[Confidential]**

Re: Your appointment with qLegal on 26th October 2021.

How we work

Thank you for attending your appointment with us and for using the services of qLegal at Queen Mary University of London. Although we cannot provide you with representation in any proceedings and do not hold ourselves out to be a firm of solicitors or patent attorneys, our advice is free, and we aim to provide the same high standard of service expected in the practice of law. Please note that the legal advice provided is in relation to the Laws of England and Wales only. If you require advice outside of this jurisdiction, please contact us.

Summary of the facts and documents you have provided

A summary of the facts you have provided is as follows:

The Business

- **[Confidential]** is a sole trader operating as a business under the name **[Confidential]** (‘**Business’**).
- The Business creates **[Confidential]**. COVID-19 altered the intended business model from “in person experiences” to “at home experiences”.

The Third Party

- **[Confidential]** (‘**Third Party**’) is wholly-owned by **[Confidential]** with company number **[Confidential]** and was incorporated on 24th October 2019.
- The Third Party is a micro **[Confidential]** practice creating **[Confidential]**, including **[Confidential]** and **[Confidential]**. The Third Party also provides freelance **[Confidential]** consultancy.

The Project

- The Business and the Third Party are jointly creating an **[Confidential]** (‘**Project**’).
- There are no written contractual arrangements between the Business and the Third Party.
- The Business is contributing **[Confidential]** and a network of business-minded contacts to the Project.
- The Third Party is contributing its experience of project leadership and its network of collaborators and contacts to the Project. Further, the Third Party will lead the design aspect of the Project whilst the overall Project will be co-managed.

- The Project commenced on 1st October 2021 but, as at the date of the client interview, 26th October 2021, no significant work has been carried out.

The Funding

- The Business and the Third Party have jointly applied for, and been granted, funding through the **[Confidential]** competition – **[Confidential]**: Fast start business growth pilot – in an aggregate amount of £24,997 ('**Funding**').
- The Funding is to be used to provide a **[Confidential]**. It will provide a one-to-one experience for the users in which each user will receive a "**[Confidential]**" and be able to provide their own "**[Confidential]**" for future users.
- The Business and the Third Party were named as Project partners in the Funding application. However, the Funding has been solely awarded to the Third Party due to the application requiring a single applicant's details in the application form.

You have provided us with the following documents:

- Application for Funding (the Business and the Third Party as partners);
- The Grant Offer Letter (the Third Party as recipient); and
- The Special **[Confidential]** Rights Accompanying Letter (the Third Party as recipient).

<u>Scope of our advice</u>

You have asked us to advise on how to arrange the formal relationship between the Business and the Third Party in connection with the Project.

<u>Summary of advice</u>

The fact that the Third Party received the Funding solely and there is no agreement formalising the relationship between the Business and the Third Party in relation to the Project presents several risks for the Business; for example, it does not have any contractual control or ownership rights over the Project (and the assets created thereunder).

Therefore, in order to protect the commercial interests of the Business, we recommend that you adopt one of the following three structures to formalise the relationship between the Business and the Third Party:

1. The Business and the Third Party set up a new joint venture entity ('**JVCo**')
2. The Business purchases shares in the Third Party
3. The Business and the Third Party enter a joint venture contract ('**JV Contract'**)

Each of these structures presents specific advantages and disadvantages dependent upon the duration of the relationship and the level of integration with the Third Party.

Given that a JVCo or an equity purchase in the Third Party may potentially result in the Grant Offer being suspended or terminated and the Funding being repaid (see appendix for the wording of section 2 and 9 of the terms and conditions), it may be the case that a JV Contract is the most suitable option allowing the Grant Offer to be left as is and enabling the parties to maintain a degree of autonomy, whilst providing some contractual protection to the Business's rights in the Project.

On the other hand, if the parties envisage that they will work together on projects in the long-term and **[Confidential]** agrees to transfer the Funding into a JVCo, the most appropriate structure may be a JVCo. We do not anticipate that an equity purchase in the Third Party is the most suitable option given that the Third Party operates activities separate from the Project (‘**Other Activities’**), and we would expect that the Third Party will not want to give the Business control or ownership rights over the Other Activities and the Business will not want to take on the liabilities of the Other Activities.

Note, this advice does not cover the specific contractual terms within a JV Contract and you will need to seek further legal advice in this respect.

Advice

Option 1: JVCo

A JVCo can take a number of legal forms, for example, a company limited by shares, a limited liability partnership or a general or limited partnership. However, for the purposes of this advice, we will focus on a company limited by shares (‘**Ltd**’) which is the most popular company structure. A Ltd is a corporate entity that is legally separate from any directors and shareholders and, as it can stand alone as a legal entity, it can enter contracts as a company and hold assets in its name. A Ltd.’s governance and formation is subject to the Companies Act 2006. The key advantages and disadvantages of a JVCo (which is a Ltd) are set out below:

What are the advantages of a JVCo?

1. A JVCo provides a single clear structure and identity which can be helpful for internal operation (e.g., enabling both the Business and the Third Party to be able to delineate their respective responsibilities and roles in the JVCo and for the deliverance of the Project) and dealings with third parties (e.g., employees, customers, and suppliers).

2. A JVCo provides a flexible foundation for raising future finance, due to the JVCo being able to hold assets in its own name and by placing floating charges over said assets.

3. There is a comprehensive legislative framework under the Companies Act 2006 which supports this type of contractual arrangement between joint venture parties.

4. A JVCo is a familiar, universally recognised structure. The relationship between the Business and the Third Party in a JVCo is typically governed through a Shareholders’ Agreement and Articles of Association which can be tailored to reflect the size, contributions and motivations of the parties. These documents will reflect a set of negotiated terms and conditions which set out the purpose, governance and operations of the JVCo (for example, composition of the board of directors, director conflicts of interest, shareholder reserved matters, deadlock and termination provisions and confidentiality).

5. A JVCo is a legal person in its own right. This enables the JVCo to own and deal in assets, sue, and be sued and enter into contracts in its own right. For example, in relation to the Project, this means that the JVCo owns the installation equipment for the Project.

6. Shareholder liability is limited to the amount each party contributes by way of share capital to the JVCo.

What are the disadvantages of a JVCo?

1. The Funding cannot be transferred to a JVCo without the prior consent of **[Confidential]** (see section 2.1 of the Grant Offer terms and conditions, which are set out in the Appendix).

2. There is a comprehensive legislative framework which can restrict flexibility.

3. There are various reporting and compliance requirements which bring increased administration and public disclosure of information (for example, a JVCo would be registered at Companies House).

4. If the JVCo is not creditworthy, then the Business and the Third Party may need to provide guarantees to third parties in order to access future funding, which in turn could mean the Business and the Third Party are severally liable for any potential failure by a JVCo to meet payment of its liabilities.

Option 2: Equity Purchase in the Third Party

An alternative option is that the Business purchases a 50% equity share in the Third Party. Purchasing an equity share in the Third Party has several key advantages and disadvantages, such as:

What are the advantages of an equity purchase?

1. The Business will gain control (by means of being a shareholder) over the Funding and the use of the Funding in relation to the Project.

2. An equity purchase enables the Third Party to be used as a medium for which to continue the Project or any subsequent projects which the Business and the Third Party may wish to engage in together.

3. Preservation of the Business's autonomy. By structuring the relationship through an equity purchase of the Third Party, this protects the autonomy of the Business enabling it to deliver projects separate to that of the Third Party.

What are the disadvantages of an equity purchase?

1. Public exposure/publicity. While an equity purchase enables the Business to gain control over the Funding, the Project will be in the Third Party's name. This therefore reduces any exposure which the Business may wish to gain through the deliverance of the Project and the subsequent custom it may generate.

2. Reluctance by the Third Party. **[Confidential]** may be reluctant to relinquish sole control and ownership over the Third Party (particularly given that it engages in Other Activities that fall outside the scope of the Project), thus rendering an equity purchase infeasible.

3. A change of ownership or the structure of ownership of the Third Party may result in the suspension or termination of the Grant Offer by **[Confidential]** and a subsequent requirement to repay the Funding. In any event, the Third Party will need to disclose the change of ownership to **[Confidential]** (see section 9.1 of the Grant Offer terms and conditions, which are set out in the Appendix).

Option 3: JV Contract

A JV Contract is a contractual relationship between two or more parties coming together for a particular business project. In this structure, the rights and duties of the participants are derived from the provisions of the contract, for example: the scope of the project, the main objectives of the project, and the individual contributions and entitlements of each participant. Unlike a JVCo, a contractual joint venture is not a separate legal entity from its contracting parties.

A JV Contract is particularly suitable for parties who wish to work together on an activity and bring different skills and resources with them. This structure is recommended if the parties wish to avoid the formalities and permanence involved in establishing a company, where they will be obliged to work within the confines of company law.

The key advantages and disadvantages of a JV Contract are set out below:

What are the advantages of a JV Contract?

1. This structure offers the parties flexibility. The Business and the Third Party will have full control over the provisions of the contract and are free to decide exactly how the Project will be conducted.

2. The parties retain ownership of their own assets and are not normally liable for the debts of the other party, but they may share liability on specific contracts with third parties.

3. A JV Contract is unincorporated, unlike a JVCo. This structure is suitable for parties who wish to avoid the relative formality and establishment under the Companies Act 2006 that is necessary in the creation of a JVCo. This may be advantageous for the Business as the relationship between it and the Third Party, and the future of the Project, is contingent upon the Project's success.

4. In a similar vein, there are fewer administrative requirements regarding the setting up and termination of a JV Contract arrangement as compared with a JVCo. This is advantageous for the Business because the Project has commenced and obtaining legal protection quickly may be attractive. Similarly, in the event of a potential future breakdown of the relationship, the JV Contract may be easily terminated. Fewer administrative requirements may also make this a cheaper option.

What are the disadvantages of a JV Contract?

1. Drafting a JV Contract can be very complex as it requires detailed provisions about the relationship, operations and duties of the parties relating to the Project. The Business and the Third Party may therefore be subject to a rigorous process to achieve the bespoke contract that is required for this structure.

2. A JV Contract lacks a separate legal identity – this means that the joint venture can suffer from a lack of clear structure and identity which may affect both internal operation and dealings with third parties. For example, we understand that the Project requires hiring of numerous subcontractors who may prefer to contract with an incorporated legal entity as opposed to the Business and the Third Party's contractual agreement.

3. This structure may be construed as a partnership giving rise to unlimited joint and several liability where each of the parties is liable for all losses of the venture if care is not taken in the drafting process. It must be expressly reflected in the drafting that it is not the parties' intention to enter into a partnership, although such a provision is not conclusive.

4. It is potentially difficult to raise external loan finance as it is not a legal entity and does not own assets – it cannot grant a floating charge as security for financing.

<u>Next Steps</u>

Based on the above, the Business should:

- Engage in discussions with the Third Party regarding the terms of the Project and the ongoing relationship between the parties.
- Agree a business plan for the Project.

- Consider the terms and conditions of the Grant Offer Letter in the context of the possible structures, for example, obtaining consent from **[Confidential]** to assign the Funding to JVCo or change the ownership of the Third Party.
- Formalise its relationship with the Third Party in a written contract in a way that best reflects the intentions of the parties.
- Seek further legal advice regarding (i) tax implications of any proposed structure; and (ii) formal drafting of the JV Contract.

We hope that the advice provides you with a comprehensive understanding of the legal questions you asked us to address. Should you require any assistance in any future matters, please do not hesitate to contact us.

We would be extremely grateful if you could take a few moments to complete this short form https://qmul.onlinesurveys.ac.uk/client-feedback-on-qLegal-2021-22, as your feedback is important to our educational development and the development of our services.

Yours sincerely,

[Confidential]
Student Adviser

[Confidential]
Student Adviser

On behalf of qLegal

qLegal
Queen Mary University of London