

Joint Ventures in Cyprus

Cyprus plays an important role in the structuring of overseas investments (mainly to Russia, CIS and India) and therefore corporate joint ventures have an important role to play for investors who wish to participate or co-operate in such investments.

The scope of this article is to provide the reader with an outline of essential legal and practical matters underlying the concept of joint ventures in Cyprus.

Definition

There is no legal definition to a corporate joint venture (the 'JV') however, one could define a JV as an arrangement by which two or more persons or entities (the 'JV Parties') agree to participate or co-operate in a commercial operation, project or business opportunity (the 'Business') through the medium of a holding company (the 'JVCo').

Reasons for using a Cypriot company in Joint Venture Structures

The use of a Cypriot company particularly in the capacity of holding company in a JV provides benefits relating to certainty, limited liability, separate legal personality, versatility, financing and tax flexibility.

The Companies Law, Chapter 113 of the statute laws of Cyprus (the 'Cap 113') contains a mature body of statutory principles, supported by an established commercial (both local and international) practice. Consequently the legal regime is defined by certainty regarding the JV Parties' legal position between themselves and in relation to the company or third parties.

The Cypriot company has separate legal personality whose member's (commercially the shareholders) liability is limited to the amount of capital they respectively contributed (or agreed to contribute) to the company and into the Business. It has the capacity to sue and be sued and has the power to own property and contract in its own right.

The separate legal personality makes a JV particularly appropriate to a Business where continuity is essential to JV Parties.

A JV in Cyprus can be versatile and able to cope with complex arrangements in terms of funding the Business (in relation to both equity and loan) and in terms of returns and earnings on such funding. The loan financing can be secured in various ways including the granting of fixed and floating charges over some or all of the JVCo assets.

Finally, the separate taxation of the JV allows the JV Parties a high degree of latitude in planning their own and their venture's tax position.

The Cypriot company is a creature of statute, a fictitious entity without physical, tangible, existence or presence and for this reason Cap 113 focuses primarily on the relationship of those which “constitute” the company, in particular, its members and directors. Cap 113 is founded on the ancient principle “the majority rules”.

The Constitution of the Cypriot company

The Cypriot company has two sets of documents which define its constitution, namely the memorandum of association (the ‘MA’) and the articles of association (the ‘AA’). Both the MA and the AA are filed with the Registrar of Companies (the official company registration office of Cyprus, a department of the Ministry of Commerce and Industry) and are available to the public.

The MA and the AA by virtue of Cap 113 form together a contract, known as the “statutory contract”, between the Cypriot company and the members as well as the members *inter se*.

The MA contains five clauses setting out:

- 1 the company name;
- 2 its domicile;
- 3 the company objects (and powers);
- 4 the limitation of its members (shareholders); and
- 5 its authorised share capital,

and it has more to do with the company’s external relations.

The AA contains regulations concerning the internal management of the company broadly relating to the following main matters:

- 1 the issue of shares;
- 2 the rights and restrictions of members;
- 3 the transfer of shares;
- 4 the composition, powers and duties of directors;
- 5 the conduct of meeting and voting both at the level of directors (board meetings) and at the level of members (general meetings); and
- 6 the right to and the distribution of dividends.

Cap 113 provides a standard set of AA (the ‘Table A’) which the company is free to adopt with or without modifications. Any such modifications are nevertheless subject to certain overriding statutory principles as well as policy considerations adopted by the courts over the years (the ‘Legal Restraints’). Nevertheless there are few Legal Restraints and the JV Parties are largely free to formulate any regulations they wish to govern their relationship in connection with the JV and the JVCo. Commercial considerations invariably dictate that Table A be modified and these regulations are

contained in the AA supplemented (if and as necessary) by a shareholders' agreement (for which see further below). Despite the forgoing the AA are closely based on the provisions of Table A for at least two reasons:

- 1 Table A provides a precedent for the matters to be covered by the AA; and
- 2 Table A has a statutory force and therefore every regulation contained in it cannot be invalid and therefore it may be followed with confidence as to its validity and force.

The AA is therefore an essential document in a JV which should be tailored to accord with the particular circumstances and requirements of the venture and to reflect the bargaining power of the JV Parties.

The Shareholders' Agreement

JVs almost invariably (except in simple arrangements) require some form of a shareholders' agreement ('SHA') also referred to as joint venture agreement. Although most of the provisions likely to be included in a SHA can, in principle and in substance, be included in the AA the object and the role of the SHA differ from those of the AA.

In our view, the AA should focus on and govern the rights and restrictions of the JV Parties as members of the JVCo. The SHA should focus on the commercial relationship of the JV Parties and how the JV is regulated as a whole. In particular the SHA should purport to:

- 1 modify the legal framework under Cap 113;
- 2 anticipate, as far as practically possible, the problems and matters which can arise particularly in relation to the management of the JV in general and the JVCo (and its subsidiaries, if any) in particular, the funding, exit issues and the distribution of profits;
- 3 confer rights to and impose obligations on the JV Parties in some capacity other than shareholders (the AA may be enforced by shareholders in that capacity only);
- 4 deal with matters which the JV Parties wish not to reveal generally to the public; and
- 5 (*most importantly*) regulate and direct how the JV Parties will exercise, in relation to the JVCo and its affairs (including the Business), their membership rights (ie the rights conferred upon the JV Parties by the AA as shareholders, the shares they hold in the JVCo, or Cap 113).

Although the actual rights and obligations of the JV Parties under a SHA are capable of wide variation depending on their commercial objectives and bargaining power, matters ordinarily addressed in a SHA include the following:

- 1 the on-going relationship of the JV Parties;
- 2 the funding of the Business;

- 3 the management of the Business and the division of matters reserved to the decision of the board of directors and of the JV Parties;
- 4 the control of the board of directors;
- 5 the resolution of deadlocks; and
- 6 the eventualities relating to the withdrawal of the JV Parties and the termination of the JV.

Many legal practitioners prefer (on the footing for better protection) that the SHA is reflected as far as legally possible in the AA. We have a different view. In drafting the AA regard must certainly be had to the SHA yet each document should, ideally, complement each other rather than reflect each other. In other words the AA should not repeat (or reflect) the provisions of the SHA as by doing so two platforms are created containing substantially similar provisions having or purporting to have the same, or practically the same, effect thereby duplicating the decision process, the steps and the procedures required to be followed or taken as well as creating two lengthy documents which overlap and become burdensome and difficult to understand, comply with and apply. This also increases the cost of managing and running the Business. As mentioned above, the AA is also subject to the Legal Restraints and there are limitations as to what provisions it may contain. For example, members of a company may lawfully bind themselves to vote in a specific way on specified matters and a typical SHA almost invariably contains provisions to that effect. If such provisions are also reflected in the AA they will be void. Finally if the AA reflects the SHA there is always a possibility that the documents contain conflicting or inconsistent provisions between them (for which see further below).

The practical approach is to have a set of regulations and provisions divided between the SHA and the AA having in mind the object and role of each document respectively. The two documents must “stand-alone”. Formalities although essential and unavoidable must nevertheless be kept to the minimum. When the Business is doing well the JV Parties tend to make pragmatic decisions paying little (if at all) attention to the formalities outlined in the relevant documents. If on the other hand the formalities are kept simple and are easy to follow the JV Parties are more likely to comply with them.

The JVCo Party to the SHA

The parties to a SHA may be all or some of the shareholders of the JVCo and may also be the JVCo itself. Depending on the merits of the venture, participants other than shareholders of the JVCo may also be parties to the SHA.

There is an obvious advantage to join the JVCo as a party to a SHA since it is useful for a JV Party to be able to sue the JVCo as well as the other JV Parties. However, many of the restrictions imposed in a typical SHA relate to the Legal Restraints and if applied to the JVCo would have the effect of fettering the JVCo statutory powers. Where Cap 113 or other statute confers certain powers on companies (e.g. the power to alter the AA or to increase its capital whether issued or authorised), these powers are mandatory and the JVCo is itself prohibited to agree to exclude them under any contract (including the AA itself being the statutory contract). Any such provisions in a SHA to which the JVCo is a party will be ineffective, at best as against the JVCo, at

worst as against also the JV Parties and even, in certain circumstances, it could render the whole of the SHA void. We do not believe it is worth the risk of having the JVCo a party to the SHA even if the SHA contains a protective provision to the effect that the JVCo will only be bound to, comply with and perform its obligations under the SHA to the extent permitted by law to do so. If the JV Parties insist that the JVCo undertakes obligations to them they (both the JVCo and the JV Parties) may enter into a separate “support” agreement, distinct from the SHA, dealing with and focusing on those particular undertakings and matters without putting the SHA at risk.

Conflicting or Inconsistent Provisions between the SHA and the AA

It is not difficult to understand why it is essential that the SHA and the AA must be neither in conflict nor inconsistent with each other; in an event of dispute the parties involved will bear an extra burden to ascertain which provisions actually govern their relationship.

The impact of conflicting or inconsistent AA *vis-à-vis* a pre-existing SHA may be that of varying the conflicting or inconsistent provision of the SHA in that the JV Parties may be treated as entering into two successive contracts (the SHA and then the AA) and the latter (i.e. the AA) will, on the basis of the usual legal principles of interpretation and construction, prevail and therefore apply.

An attempt to offset the above effect by including in the SHA a provision (the so called “conflict clause”) to the effect that the SHA prevails over any inconsistent or conflicting provisions contained in the AA may not always have the desired result. The “conflict clause” may be taken to have amended the AA by means of a “deemed special resolution” introducing in the AA a void and otherwise an unenforceable provision being one which the AA is prohibited under the Legal Restrains to contain. Also, under Cap 113 all special resolutions and the documents annexed to them must be filled with the Registrar of Companies. This is an irritation at the least as the directors (and the secretary) of the JVCo would technically be in breach of their duties under Cap 113 and subject to sanctions if this was discovered too late. Moreover, the SHA may require registration with the Registrar of Companies and become a document available to the public. Care must therefore be had when drafting a “conflict clause” to ensure that the SHA does not amend the AA in any way.

Registration of SHA with the Registrar of Companies

Cap 113 requires the registration of the MA and the AA. Accordingly if the SHA is treated as part of the AA it must, naturally, be registered and its provisions will also be subject to the Legal Restrains and hinder its enforceability and applicability.

It is therefore in the interests of the JV Parties that the SHA is not treated as part of the AA. This is, in our view, best achieved if:

1. the JVCo is not a party to the SHA; and
2. the “conflict clause” is drafted in a way that does not amend the AA; and
3. the AA does not contain cross-references to the SHA.

Points 1 and 2 have been discussed above. In relation to point 3 it is often difficult to draft the AA without cross-references to the SHA nevertheless little ingenuity may avoid the need to do so. For example, the wish of the JV Parties that the transfer of shares in the capital of JVCo is prohibited unless the transferee (if not already a party to the SHA) has previously signed an adherence agreement under which he agrees to comply with the provisions of the SHA can be dealt with in the AA by introducing a provision to the effect that the directors of the JVCo will refuse to register the transfer except with the consent of all the members of the JVCo and in the SHA by introducing a provision to the effect that the JV Parties will consent to any transfers of the shares provided that the transferee has previously signed the adherence agreement.

Remedies

The remedies available to the innocent JV Party in an event of a breach of the SHA include damages, specific performance and injunction.

Damages in principle aim to put, in so far as money can do so, the innocent JV Party in the position he would have been had the SHA been performed without breach in accordance with its provisions.

Specific performance requires the JV Party in breach to perform the SHA in accordance with its provisions. Unlike damages a remedy available as of right, specific performance is subject to the discretion of the court. A SHA can in appropriate circumstances be specifically enforceable. The remedy will be awarded if it is fair, practical and if it sought promptly after the occurrence of the breach. Despite these conditions it will not be awarded if, *inter-alia*, damages is an adequate remedy.

Injunction is in nature a prohibitive remedy and requires the JV Party in breach to halt his course of action. Like the remedy of specific performance, the remedy of injunction is discretionary and it is subject to the same conditions referred to above relating to specific performance.

Forum

Generally the JV Parties may choose any law (forum) to govern the SHA. Nevertheless whatever law is chosen the Cypriot law and regulations will always be relevant to a JV for it applies to the MA and AA regardless of the chosen law. Ideally the SHA should be governed by Cypriot law.

Conclusion

The legal and tax regimes in Cyprus are able to cope with a wide variety of commercial arrangements and corporate structures. Cypriot law is flexible to allow those participating to plan their tax position while accommodating their commercial wishes under an established legal environment.

The participants are largely free to formulate any rules they wish to regulate and govern their joint venture relationship. These rules can be divided between the constitution of the joint venture company and the joint venture agreement without

compromising their effect, validity or enforceability. The rules contained in the joint venture agreement may be kept in confidence from the public.

Although the joint venture company may be a party to the joint venture agreement the participants can instead direct the company to conduct its affairs in accordance with the agreement without the company itself needing to be involved or be a party to it.

Cypriot law has sufficient remedies available to the participants to ensure the performance of the rules which formulate the joint venture and to secure their respective rights under or in connection with it.

FURTHER INFORMATION

Please contact any of the following lawyers if you require additional information on Cyprus joint ventures.

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