

## **PRACTICAL LEGAL CONSIDERATIONS FOR EXPORTING BUSINESSES**

The focus of this presentation is on practical legal considerations which promoters of any stage business should have regard to when exporting goods and/or services.

In the time available today, I can realistically only touch briefly on each of the topics covered and I have included at the end of the paper a list of useful sources of additional information on some of the topics covered.

I intend to concentrate on the following areas I believe that in practice are areas that likely to be of relevance to you to a greater or lesser extent.

- ❑ Types of Businesses
- ❑ Sole Trader and Partnerships
- ❑ Limited Liability Companies
- ❑ Operating a Branch and Foreign Subsidiaries
- ❑ Joint Ventures
- ❑ Strategic Alliances
- ❑ Franchising
- ❑ Agency Agreements
- ❑ Distribution Agreements
- ❑ Choice of Jurisdiction
- ❑ Intellectual Property Rights
- ❑ Common Sense

### **1 TYPES OF BUSINESSES**

There are various ways in which a company or business in Ireland can commence operations in a new jurisdiction – e.g. open a branch, incorporate a new company, enter into a joint venture, franchise or distribution agreement with a third party.

Each type of business opportunity will have its own advantages and disadvantages and it is for the promoters of a business to determine how they are going to conduct their business at home and abroad.

The promoters will need to identify their business objectives in order to determine the manner in which those objectives will be best achieved. There may be many factors which will impact on the ultimate decision – legal, tax and personal factors to name just a few.

### **2 SOLE TRADER**

One option for running a business at home and abroad in a new jurisdiction is to operate as a sole trader or, if there is more than one promoter involved, as a partnership.

The main disadvantage of this route is that the promoter(s) do not enjoy the benefit of limited liability which incorporating a business as a limited liability company provides to the shareholders of that company. In simple terms the promoter(s) of an unincorporated business are personally liable for the debts of the business.

An advantage of the sole trader business model is that there are fewer compliance obligations to consider than with a company under the applicable jurisdictions' relevant company law legislation. Therefore, compliance costs associated with the business may be a lower.

In many cases businesses are initially set up as a sole trader operation or as a partnership and as the business expands are subsequently transferred into a limited liability company

structure. If you are considering adopting this approach you need to be vigilant that this does not trigger unintended tax charges.

### 3 PARTNERSHIPS

In most jurisdictions a partnership is the legal relationship which arises when “*two or more persons [are] carrying on business in common with a view to a profit*”.

There are essential differences between a partnership and a limited liability company, namely:

1. a partnership does not have a corporate existence separate from its partners; and
2. the partners do not enjoy limited liability like a shareholder has in a company.

In other words a partner may find himself liable for the debts of the business operated by the partnership even where those debts were incurred by another partner without his knowledge. This is because the acts of one partner generally bind the other partners.

As with the sole trade business model an advantage of a partnership is that there are fewer compliance obligations to consider than with a company under the applicable jurisdictions' company legislation. Therefore, compliance costs associated with the business may be a lower.

It is not necessary for a formal partnership agreement to be put in place in order for a partnership to come into existence. In most jurisdictions a partnership can arise simply from the conduct of two or more persons carrying on a business in common. Therefore, promoters must be very careful to ensure that they do not fall into an overseas partnership with a foreign person or company by accident.

### 4 LIMITED LIABILITY COMPANIES

There are several legal advantages to incorporating a business and registering it as a limited liability company. There may also be various tax advantages for the promoters of the business which should also be taken into consideration at an early stage.

It should be noted that most jurisdictions also enable promoters of business to set up limited liability company or business in one guise or another and it is always best to take specific legal and tax advice from that particular jurisdiction.

#### 4.1 Advantages of a limited liability company

In general the advantages of incorporating a limited liability company are:

##### 4.1.1 Limited Liability

Limited liability puts a limit or ceiling on the responsibility of the shareholders to pay the debts of the company if the company becomes insolvent

In effect, limited liability allows individuals to enter into business with a limited risk of loss in the event of the business failing. This may be one of the main attractions particularly where a business is entering into an unfamiliar jurisdiction and is unsure as to how the business will perform.

This is a general statement and, in Ireland and other jurisdictions, is subject to several exceptions where the relevant Companies Acts may provide that an individual

(normally where such person is also a director) can be liable personally for some or all of the debts of a company.

Irish examples of where a person may incur personal liability include where a shareholder who is also a director is guilty of reckless trading or fraudulent trading or where the director is guilty of failing to maintain proper books and records and such failure contributes to the company's insolvency.

#### 4.1.2 **Borrowing**

A business trading as a company may be able to secure borrowings in ways that an individual cannot. To illustrate this I need to explain the difference between a fixed and floating charge.

When a fixed or specific charge is created, the fixed assets of the business (i.e. land, buildings) are given as security for loans by the relevant lending institution. While this form of security may also be available to the individual, a floating charge is a form of security which can be only utilised by a company.

A floating charge is one which in effect does not attach to specific items of the company property but "floats" or "hovers" over the property (including property acquired after the date of the creation of the charge) until an event of default occurs and then the floating security crystallises over the company's property at the time the event of default occurs. In this way it is a suitable way of giving security over assets like stock in trade that is constantly changing.

#### 4.1.3 **Transferability Of Interests**

A person's interest in a company is normally represented by shares which, subject to any applicable restrictions in the articles of association/internal rules of the company, can be transferred by one person to another.

### 4.2 **Incorporating A Company**

A private company limited by shares is the most common form of company used for trading purposes. It has no minimum capitalisation requirement and can be set up with just one person holding a single share.

In Ireland every company must have at least two directors and a secretary (who may be one of the directors).

In Ireland, a director can (with some exceptions) only hold up to 25 worldwide directorships and this may prove problematic in the future if the business model is going to be copied and rolled out over many different jurisdictions with the same directors having management of the various companies.

An Irish company must have at least one Irish resident director or it will be required to post a bond in the amount of €25,395. There may also be residential requirements in other jurisdictions and you should research these before attempting to set up a foreign company.

In order to set up a company there are a number of forms and documents which must be submitted to the relevant Registrar of Companies. If all of the documents are in order the Registrar will issue a Certificate of Incorporation. It is at this point that the company's separate legal personality commences. A company then can begin business, open bank accounts, borrow money and enter into contracts and so forth.

### 4.3 The Memorandum of Association

In general most companies will have a document – in Ireland called the Memorandum of Association – which is effectively the constitution of the new company which sets out (amongst other matters) the objects of the company.

The objects of a company authorise the company to do certain things – i.e trade, enter into leases, borrow monies etc etc.

If the company is going to trade abroad then there should be a specific object in the Memorandum of Association to allow this (alternatively there should not be any restrictions in the Memorandum of Association on where the company can carry on its businesses).

### 4.4 Ongoing Compliance

A limited liability company in any jurisdiction will have ongoing compliance requirements. The most important recurring compliance obligation of a company is to prepare accounts on an annual basis which also must be filed with the relevant Companies Registration Office with a company's annual return.

In addition to hefty late filing penalties a company can be struck off the Register of Companies for failure to file annual returns. If a company is struck off then the ability of the company to trade ceases.

Restoration to the Register of Companies involves filing the documents that were not filed and paying the associated filing fees and late filing penalty payments and, where the company has been struck off for a year or more, an application to the High Court with all the costs associated with that.

*For more information on this subject relating to Irish companies there is a more detailed paper available on the LK Shields website ([www.lkshields.ie](http://www.lkshields.ie)) entitled "Practical Aspects of Establishing and Running a Company".*

## 5 OPERATING A BRANCH OR INCORPORATING A FOREIGN SUBSIDIARY

A company incorporated in Ireland (or elsewhere) may trade in another jurisdiction either through a subsidiary company resident in that jurisdiction or through a branch office (the "**Branch**").

The Branch can sign contracts which are binding on the overseas company.

To register as a Branch you must establish a place of business in that jurisdiction through which the company conducts its business. This allows people resident in the Branch's jurisdiction to directly deal with the Branch itself rather than having to deal with the main company (situated outside their jurisdiction).

Places of business which perform operations ancillary to the company's business are generally not branches within the required meaning.

You should check local legislation to determine whether you need a place of business in that jurisdiction if you wish to incorporate a subsidiary company as opposed to a branch.

The decision whether to establish a Branch or to incorporate a foreign subsidiary must be taken separately in each case, but is normally based on the following considerations:

## 5.1 **Commercial**

A subsidiary is often preferable because some companies would prefer to do business only with other companies incorporated in the same jurisdiction. Grants, loans and other finance may also be easier for a company in a particular jurisdiction to arrange.

## 5.2 **Taxation**

The relevant considerations are normally the tax system in which the overseas company does business, the terms of any double tax convention between the relevant jurisdictions and the expected trading results.

Sometimes it is more advantageous to start with one structure and then to transfer the business to the other structure. For example, the starting up costs and initial trading losses of a branch may be deductible from taxable profits of the overseas company in its home country but this advantage may be lost when the Branch becomes profitable in its own right.

## 5.3 **Legal**

A foreign subsidiary may afford some protection to its parent from trading and other losses or liabilities of the foreign operation, since the parent will benefit from its limited liability.

However, this will not always be a protection, eg the parent will be fully liable where it has guaranteed the liabilities of the subsidiary.

## 5.4 **Audit**

In certain jurisdictions statutory audit of a company's accounts are not always required.

## 5.5 **Publicity of Accounts and other information**

Under certain jurisdictions companies have to file annual accounts which are available for public inspection. A Branch has to file the accounts of the overseas company. Translations of the accounts may be required (depending on the relevant jurisdictions).

The disadvantage of revealing the overseas company's accounts can be removed by interposing a further foreign jurisdiction company between the overseas company and the Branch, so that the Branch becomes a Branch of the subsidiary of the overseas company.

Various jurisdictions have different reporting requirements and you should take advice in the relevant jurisdiction.

## 6 **JOINT VENTURES**

Joint Venture is a term that is frequently used to describe a business arrangement between a number of separate businesses under which they agree to pursue a common objective.

Under a Joint Venture Agreement the businesses will agree to combine all or certain aspects of their knowledge, expertise and resources in a new business venture with each party contributing something to the new business and ultimately where the new business is

successful receiving something at the end in return for their original and ongoing commitment.

Joint Venture Agreements are not generally found in a standardised form as there is not a formulaic approach to creating a joint venture.

The structures that are used will depend on a number of factors including the requirements of the parties, taxation aspects and other commercial considerations.

## 7 STRATEGIC ALLIANCES

Strategic alliances can be a valuable way of gaining access to a reliable outlet for products and/or to distribution channels and/or technology that an SME needs and is often but not always accompanied by the strategic partner taking an equity stake in your business. However before going down this particular route you need to assess whether the potential benefits of doing so outweigh the potential risks.

A strategic partner will want to evaluate the technical quality and market potential of your product and most probably will have the in house technical expertise to do so as it will most likely be involved in a similar or related business to your own.

Accordingly it is more than usually important to put in place a strong **Non Disclosure Agreement** prior to the disclosure of any sensitive information as otherwise if such a company is given free access to your idea it may steal the idea and launch its own version or improve its own products having benefited from access to your ideas. Again without the benefit of a Non Disclosure Agreement you may find it difficult if not impossible to challenge such actions.

The type of Non Disclosure Agreement you would use in such cases is generally much more detailed than the types of Non Disclosure Agreement you may be familiar with and it can take a bit of time to achieve an agreed version of such Non Disclosure Agreement with a prospective strategic partner. They will naturally be cautious about agreeing provisions which are restrictive on them when they do not know whether there is anything novel about your idea. Prudence dictates that you should only deal with prospective strategic partners that are known to conduct themselves in a professional manner.

In addition before taking on a strategic partner you should consider not only your short term needs but also longer term considerations.

For example, if a strategic partner takes an equity investment and a seat on your board of directors you need to consider whether such partner and/or its board representative should have its right of access to information regarding your company's technical developments restricted in some manner.

Will the creation of a strategic alliance ultimately make it more difficult to access other distributions channels?

If a strategic partner takes an equity stake in your company it may make it extremely difficult to sell your company to any other trade purchaser as the strategic partner may have pre-emption rights or even a right of first refusal on the company or some form of veto on who the company may be sold to.

Even if none of these concerns apply a strategic partner who makes an equity investment may have a higher expectation of a return on an exit than the promoters have and may well have an influence on the timing and strategy of an exit.





















