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Verne, B. Michael

From: [redacted]
Sent: Wednesday, October 19, 2005 7:52 AM
To: Verne, B. Michael
Subject: new rules question

Mike: I want to be sure I'm giving a client accurate advice on something. They're forming a rather elaborate joint venture with another company, with a 51/49 right to profits/assets configuration. The joint venture agreement envisions that the parties will develop a number of new products and will construct the facilities to manufacture and sell those products worldwide. Because at the time of formation the 49% owner is contributing only cash and the 51% owner is contributing all of the non-cash assets, the formation (an LLC) will not be reportable.

My question relates to the potential reportability of possible later shifts of that 51/49 ownership arrangement by reason of (a) additional capital contributions and/or (b) other events occurring within the joint venture.

It seems pretty straightforward that if, for example, the parties make additional capital contributions a year from now, and the lopsidedness of the contributions causes the to shift the right to profits/assets to 49/51, that's simply an acquisition of control by the former minority party, and is potentially reportable. (The acquisitions of the contributions by the JV might also be reportable, even if the change of control is not.)

Similarly, if the parties simply decided to restructure the rights to profits/assets without any additional capital contributions by either party, that presumably would also be potentially reportable.

Suppose the JV agreement says something like this: Party A will work to commercialize Product A, and Party B will work to commercialize Product B, and if in Year 3 the profits from Product A exceed the profits from Product B, then the ownership percentages will automatically shift from 51/49 to 49/51. I'm hypothesizing a shifting resulting from some event other than an additional contribution to the JV by either party. My question is whether that is an acquisition of a controlling non-corporate interest.

Is the test whether there is some volitional shift of control (as opposed to an automatic -- i.e., non-volitional -- shift)?

Does the language in the SBP about whether the right to profit and/or the right to assets upon dissolution is variable or fixed come into play here? My example was meant to suggest that the rights to both profits and assets is fixed at the time of formation but under the JV arrangement both of them become variable over time, depending upon events within the JV.

Any guidance?

[redacted]

1) AGREE THE FORMATION IS NOT REPORTABLE.
2) AGREE - ADDITIONAL CONTRIBUTIONS THAT CAUSE A SHIFT TO 49/51 POTENTIALLY REPORTABLE
3) AGREE - IF THE PARTIES AGREE TO SHIFT, POTENTIALLY REPORTABLE EVEN IF NO NEW CONTRIBUTIONS
4) AUTOMATIC SHIFT IN FUTURE NOT REPORTABLE. TEST IS VOLITIONAL SHIFT OF CONTROL
5) THE RIGHT TO PROFITS/ASSETS IS FIXED AT THE TIME OF THE FORMATION.

B Michael