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Joint Venture/Joint Stock Company Checklist: bridge connection

Joint Venture Checklist

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Introduction

Joint venture arrangements in infrastructure projects were until recently generally only relevant to regulating the relationships between private parties to a project company in a Build-Own-Transfer (BOT) or concession project. There is increased use of them between public utilities and private parties, often in combination with or following the corporatization of a public utility.

Examples of this in the Water and Sanitation sector are:

- Cartegena, Colombia (*expresa mixta*)

Cartegena, Colombia (expresa mixta)

- Tallinna, Vesi, Estonia

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You can also check out Joint Ventures and Government Shareholding in Project Companies.

Below are a checklist of issues to consider when putting together joint venture arrangements – in the case of a joint venture or joint stock company, these will be generally found in the shareholder agreement, but will need to be consistent with the constitutional documents of the company and the law:

Preliminary issues

1. Structure of joint venture:

Should it take the form of:

- a joint venture company with its own legal identity separate from those of its shareholders, in which the parties will participate on an equity basis, and there is a limitation on liabilities – in the context of project finance or joint venture between the public and private sectors, this is recommended;
- a partnership arrangement – an arrangement with profit sharing between partners created for a specific purpose – no separate legal entity created and each of the partners with full legal responsibility for the project, generally there is no limitation on liabilities unless this is a formalized into a limited partnership;
- a contractual consortium – parties contract to work together on a specific project – there is no concept of sharing of pool of profits as there is with a partnership – each party likely to be remunerated for specific services provided to the consortium. No separate legal entity created and limitations of liability

will be set out in the contract, if at all.

2. Purpose of the joint venture

- In the case of project financed transactions, the banks will be anxious to ensure that the joint venture does not diversify into any risky activities and so will impose restrictions on what the joint venture may engage in.
- Even where there are no bankability considerations, the parties should be clear as the objectives and purpose of the joint venture and whether the joint venture should be permitted to diversify etc.

Joint Venture Company – Key Issues

Assuming that the parties will want a separate corporate entity, we set out below the key issues to consider in establishing it:

Equity/ shares

- Will it be a 50:50 deadlock joint venture, or will one party have a majority interest?
- Will economic ownership and voting rights be the same?
- Should there be different classes of shares, with different rights attached to them or different levels of priority, such as ordinary and preference shares? Preference shares tend to have a set rate of return (or coupon) (provided that there are sufficient distributable profits) and the shareholders will be paid out in priority to the ordinary shareholders on insolvency?
- In the case of a public private joint venture company, where there is provision for future dilution of public interest, will the government still want to retain a “golden share” that would give it certain non-economic interests such as the right to veto the successor in title or the right of the company to change its charter? This is a tool that was commonly used by the UK government in partial/ whole privatizations of public companies.

Funding

- What will be the initial and future contributions of each of the parties?
- Will initial capital be provided in cash or non-cash assets?
- If non-cash assets, how will these be valued?
- What will the initial debt/equity ratio be? In project finance deals this will be scrutinized by the banks.
- Will the parties undertake obligations to contribute further capital?
- Will there be shareholder loans?
- Will the parties be obliged to provide guarantees or counterindemnities to support finance raised by the joint venture?
- By what authority or procedure are new issues of shares to be made – by mutual agreement or by majority decision of the shareholders or board of directors? Pro rata offerings are also possible.
- Will there be outside finance such as project finance secured on, and serviced from, the income stream of the venture?

Corporate Governance

- What rights will each party have to appoint directors?
- Who will appoint the executive management team?
- What authority is to be given to individual managers (e.g. CEO) (this is usually set out in a schedule to the joint venture (JV) agreement and then approved at the first board meeting) and what matters must be dealt with at board level?
- What will the quorum for the board be?

- Will the Chairperson of the Board have a casting vote in the event of deadlock?
- What matters are to be reserved for decision by the shareholders themselves – and/or will a super-majority vote be required for particular decisions at shareholder or board level[1]? Matters to consider include:
    - changes in the joint venture company (JVC)'s articles of association;
    - new issues of share capital (including grant of share options);
    - significant changes in the nature of the JVC's business;
    - major acquisitions or disposals;
    - annual revenue/capital budget;
    - capital expenditure or contract commitments above pre-agreed limits;
    - borrowing limits;
    - dividend policy;
    - appointment and dismissal of key management;
    - material dealings with intellectual property rights; and
    - dealings between the JVC and its shareholders (except, perhaps, arms' length dealings in the ordinary course of business).

Minority Protection

If a minority participant is involved, it will wish to protect its interests through:

- participating in management through board representation;
- being involved in major decisions (including, possibly, a right of veto);
- protecting against its equity stake being improperly diluted;
- ensuring proper distribution of profits;
- establishing adequate access to information regarding the joint venture's affairs; and
- establishing exit routes (including, possibly, put option rights or tag along rights – see below).

Dividend Policy

The parties should have a common understanding about the dividend distribution policy to be adopted by the joint venture clearly setting out when dividends should be issued, particularly where profits need to be reinvested in the business. This is particularly important as distribution of dividends can only be made out of distributable profits and at the discretion of the board and shareholders. A private or minority party will also want to be sure that distribution of dividends will not be blocked by the other party(ies) if minimum profit levels are reached, although in some jurisdictions such a commitment may not be enforceable.

Non-compete clause

It may be necessary to prevent or limit competition between one of the parties and the joint venture. Any non-compete obligations will need to be drafted carefully in terms of:

- scope (territory or field) of restriction; and
- exceptions (e.g. freedom to run or acquire businesses not significantly in a competing field – possibly subject to offering the competing business to the joint venture)[2].

Termination/ Exit provisions

When, and how, should a party be able to terminate its interest in the joint venture?

(a) Unilateral exit or termination allowing one party to terminate and/or exit by notice.

It usually involves a right to sell to a third party purchaser subject to a right of pre-emption (i.e. right of first refusal) in favor of the continuing party(ies).

The parties may require consent of the other shareholder(s) for all transfers; the question then is whether a party should have a right to compel liquidation in certain circumstances.

(b) Termination for cause or upon a "trigger event"

This is where a particular event triggers the right of another party to institute a call option or other termination procedure. The 'trigger event' needs to be carefully defined e.g.:

- insolvency of a party;
- change of control – inclusion of a change of control provision can be material and contentious, particularly if the joint venture comprises a significant element of a party's business;
- material breach – this is often more relevant for a venture where funding commitments are significant; and
- deadlock (see below).

How items such as guarantees, defects and insurance will be handled after termination.

Put/call options

Sometimes the parties will agree at the outset that one party will have a right, at a specified time and usually at a specified price or at a third party valuation, to 'put' its shares (i.e. to require the other party to buy its shares in the JVC) or to 'call' for the other party's shares (i.e. to acquire that other party's shares).

Pre-emption rights and drag-along and tag-along rights

It is common for joint ventures to include contractual provisions whereby, before a transfer of shares to a third party, the other shareholder(s) are given a pre-emption right. Points that arise include the following.

The price may be set by reference to a price:

- that an identified third party purchaser is prepared to pay (the continuing party having a right to match that price – a right of first refusal);
- proposed by the transferor before it finds a third party purchaser (the continuing party having a right of first offer at that price); or
- determined by a third party evaluator (if so, it will be important to establish the valuation criteria to be applied, including whether a discount/premium is to apply to reflect the size of the shareholding being sold).
- If a majority party wishes to sell, should it be entitled to 'drag along' the minority party (i.e., require the minority party to sell its shares at the same price per share as that offered by the third party) so that it can deliver the whole JVC to the third party? [THIS WILL BE CONTENTIOUS]
- Should the minority party have the right to 'tag along' or 'piggyback' by requiring that a third party purchaser extends to the minority party the same offer price per share as it is offering to the majority party?

Deadlock resolution

Joint ventures have an inherent prospect of management deadlock, even if it is only on the issues where the minority party has a power of veto. The parties will need to decide whether, in the interest of certainty, to set a contractual solution for breaking the deadlock, or whether the parties will by necessity in a prolonged deadlock situation have to reach an agreed solution. Possible solutions could be:

- Any deadlock or dispute to be referred to the Chairman or chief executives of the joint venture participants, to an intermediate panel of executives or to a formal mediation procedure.
- For any prolonged and fundamental dispute, a right to terminate and initiate liquidation or to commence a 'shoot-out' procedure between the parties as a result of which one party will buy out the

other:

- a Russian roulette procedure allows one party to offer to buy the shares of the other party at a certain price – but the other party has the right to decide either to accept and sell its shares or, instead, to buy out the first party's shares at the same price; and
- a Texas shoot-out (at least in some variants) occurs where both parties wish to buy and a sealed bid procedure takes place to determine the higher bidder.

Personnel – will parties be contributing personnel – in the case of a utility, how will these be supplied to the JVC – by secondment or transfer, etc.?

Business Plan

The business plan is rarely itself a legal document and failure to achieve future targets will not usually give rise to a legal claim. However, it can be a vital document to ensure that the joint venture parties have clear objectives for the venture. It is common to identify the opening business plan in the joint venture agreement.

Liabilities

- to what extent individual parties should be liable for liabilities of JVC, if at all?

Accounting Policies

- The accounting principles and policies to be adopted by the joint venture should be addressed from the outset.

Intellectual Property

- to the extent that a party is bringing intellectual property rights into the joint venture, how this will be respected, whether the JVC will have a license to use it, etc.

Dispute Resolution

- should the parties rely on the local courts or do they want to follow an alternative form of dispute resolution, such as arbitration?

Governing law

- normally the governing law in these cases will be the law of the country of incorporation of the company.

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[1] The law may stipulate decisions that need to be decided by a super-majority.

[2] Non-compete clauses may be found to be invalid in certain jurisdictions if too broad in scope – check with local lawyers

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