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Elements for Governance of Project Company (JV)

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Module 10 of the Annex in Asset Recycling.

There are various ownership models that may be applied to an asset recycling transaction. Most commonly, an asset recycling transaction is effected by way of the “Concession/ Lease Model” whereby the transaction is implemented through a newly established Indonesian limited liability company formed by the selected private sector investor as a special purpose vehicle (the Project Company).

A variation to the Concession/ Lease Model is the Joint Venture (“JV”) model whereby the Relevant Authority holds an interest in the JV SPV/Project Company as a shareholder together with the private sector investor(s).

The JV model involves specific governance considerations given the Relevant Authority shareholding and involvement and the perceived risks of misalignment of interests between the private investor(s) who are meant to come in a shareholder of the joint venture company ("JVCo") against the payment of an asset recycling upfront fee (and will therefore have certain return on investment requirements) which will not be the case of the Relevant Authority.

This checklist sets out some of the key aspects relating to the governance of the future joint venture company which an SOE contemplating to prepare and enter into an asset recycling transaction on the basis of the JV model should bear in mind and seek to address together with its transaction advisors at the transaction preparation stage. *Find more below, or visit the Guidelines for Implementing Asset Recycling Transactions section and Content Outline, or Download the Full Report.*

In asset recycling transactions involving the JV model, the SOE should consider setting out the key terms and its position on the items of this checklist in a term sheet of JV key terms and conditions specifically developed for the Asset to help interested parties/investors take an informed view of the asset recycling transaction and opportunity and help them to formulate a competitive bid. Ultimately, these key terms would be reflected in the shareholders' agreement ("SHA") between the SOE (or its relevant affiliate) and the private investor(s) appointed as joint shareholders pursuant to the JV partner procurement process.

Key Considerations:

S.No.	Matter	Description	Key considerations
JVCo Constitution			

S.No.	Matter	Description	Key considerations
1.	Shareholding	The shareholding in the JVCo is to be determined to reflect the interests of the parties (private investor(s) and SOE)	The private investor(s) will have a strong preference if not a strict requirement to have control over the JVCo. Depending on the specific context of the Asset and sector, this may also involve having qualified majority rights (i.e. more than 66.2/3%) to be in a position to determine largely alone the strategy of the JVCo and for the operation of the Asset but this would largely depend on the proposed arrangements for the governance of the JVCo (see items 6 to 14). Alternatives to this could include scenarios where the private investor party will have a minority shareholding (for ex. 49%) but operational control or joint control over the JV and asset. One of the considerations for the shareholding percentage of the respective parties (private and SOE initiator) will be whether the relevant business activity of the JVCo is subject to any foreign ownership limitations.
2.	Shares	Class of shares and rights attached to shares	Besides the point above about the shareholding percentages in JVCo, another aspect of governance and the rights of the shareholders (private investor(s) and SOE) over the JVCo may derive from the types of shares in JVCo that can be issued. The SOE should consider the governance of JVCo as a whole (including actual shareholding, the types of rights associated with JVCo's shares and the general decision making process within JVCo) and consider whether all shares will rank equally and with the same rights and obligations attached to them or whether it is preferable to have different classes of shares to allow certain enhanced rights in favour of a Shareholder (the private investor(s) for example).
3.	Conditions Precedent	Conditions Precedent to be fulfilled by the shareholders (private and public) for the JVCo structure to become effective	The SOE will need to determine whether the circumstances of the Asset or the particular asset recycling transaction require any conditions precedent to be fulfilled by the selected investor or the SOE itself. This may be the case for example where certain approvals might be required for the Asset to be transferred into JVCo and if JVCo is to apply for and hold certain material permits required to own and operate the Asset. If any of the conditions precedent are not satisfied or waived by a suitable date to be nominated by the parties, either party would typically be able to terminate the SHA.

S.No.	Matter	Description	Key considerations
4.	Nature of Business and Objectives	Purpose of JVCo should be defined	The SOE will have to determine and describe the activities and business which the JVCo may engage in. This would typically be limited to operating (and potentially re-developing, expanding, renovating,…) the Asset.
5.	Commitment	Level of commitment required by each shareholder	Private investors will typically expect where there is a shareholder which is designated by an SOE (including potentially the SOE itself) that the SOE shareholder will be responsible to support the JVCo in relation to any matters which involve or depend on government institutions or other SOEs (such as permits and licences, project and tax incentives, certain types of land rights,…). The SHA would typically set out the level of commitment required from each Shareholder with regards to running the Business as well as any specific responsibilities of each Shareholder (for example, will the SOE Shareholder provide any supporting services or assign any existing contracts to JVCo?).
Governance			
6.	JVCo Board	Composition of JVCo Board	The SOE will have to consider the composition of the Board of Directors ("BOD"). It is likely that the private investor(s) will require/desire to have control over the BOD which is responsible for the overall management and operations of the JVCo through its oversight of the Executive Team.
7.	President Director	Who appoints the President Director?	It is likely that the private investor(s) will require to have the right to appoint the President of the JVCo given its role as primary executive of the company in charge of overseeing its operations. A further point to consider is the level of authority and discretion delegated to the President and matters which require JVCo being represented by more than 1 director (possibly a joint representation of directors appointed by each Shareholder) or the BOD.

S.No.	Matter	Description	Key considerations
8.	Board meetings	Agree initial governance mechanisms for JVCo's Board meetings	Depending on the actual shareholding of JVCo (see item 1 above), the SOE should consider whether specific quorum and voting requirements should be provided for strategic matters which allow the representative (directors or commissioner(s)) of the SOE to be involved in the decision process on those matters. Examples of points to be considered include (i) whether certain matters require quorum and decision to be fulfilled by representatives of both/all shareholders (i.e. from the private investor(s) and SOE) and (ii) whether the President has any tie-breaking vote.
9.	Executive Team	Appointment of executive team to manage daily operations of Business	In addition to the BOD, the SOE should consider the composition of the executive team and whether it wants to be able to appoint some of the executives of the JVCo (such as for example the head of human resources, the chief financial officer or any other critical operational executive function). Here again, it can be expected that the private investor(s) will prefer to have as much control as possible over the functioning of JVCo and that any departure from this principle will have an impact on valuation.
10.	Executive Powers	Powers of the executive team	The SOE should consider the powers and responsibilities of the executive team which would typically be in charge of: • the day to day management of the Business of JVCo and the Asset; • preparing and submit to the BOD a business/working plan and budget each financial year; • implement the business/working plan and budget adopted by the BOD; • be authorised for other expenses up to a certain threshold (beyond which BOD approval is required).
11.	Shareholder meetings	Agreement on matters to be determined by shareholders only	The SOE should consider matters which should be decided by the shareholders with the meeting quorum above the minimum quorum matters provided under the applicable laws.

S.No.	Matter	Description	Key considerations
12.	Voting and Decision Making	Matters requiring unanimous approval of Board/Shareholders (Reserved Matters)	The SOE should consider matters which require unanimous approval of shareholders with the meeting quorum above the minimum quorum required under applicable laws. This would typically include: 1. the appointment of an administrator or liquidator to JVCo or any proposal to wind up JVCo; 2. any alteration of the Articles of Association ("AoA"); 3. any alteration to the rights conferred by the shares in JVCo; 4. the sale of the whole or part of any material undertaking of JVCo including the sale of any assets with a value above a certain threshold; 5. alter its authorised or issued share capital in any way (including issuance of shares or any securities, purchase or redemption of its own shares, granting of options over any shares or other securities, provision of further capital or reduction of capital, consolidating, subdividing or converting any shares or other securities or varying any of the rights attaching to any such shares or other securities); 6. subscription for, or acquisition or sale of, any securities in any other company including, without limitation, the formation, sale or acquisition of any company as a subsidiary of JVCo; 7. execution of contracts between JVCo and any Shareholder or any related entities or individuals; or 8. commencement of any new business (other than the Business as determined in item 4), cease to conduct any part of the Business or materially alter the scale of operations of the Business; 9. the giving of any loan or facility to another party (whether a related party or not) or to obtain loan facility from any party; 10. appoint, dismiss or vary the terms of engagement, role or responsibilities of the President; 11. appoint, dismiss or vary the terms of employment, role or responsibilities of other members of the Executive Team; 12. list any of the securities/shares of JVCo on a stock exchange; 13. restructure the capital of JVCo; 14. give a loan or other financial assistance to: ◦ any Director; ◦ any Shareholder; ◦ any person or entity that controls or is controlled by or relatives of a Director or Shareholder; 15. acquire or dispose of any interest in any real property (including any leasehold interest); 16. enter into any contract or arrangement outside the ordinary course of the Business;

S.No.	Matter	Description	Key considerations
13.	Deadlock	Determine any suitable process to resolve deadlocks	Depending on the proposed governance of JVCo (including the effective shareholding and any related governance rights of the respective Shareholders – such a rights conferred by different classes of shares), the SOE should consider whether deadlocks may arise and the appropriate principles and process to resolve the same.
Funding and financial obligations			
14.	Business Plan and Budget	Adoption of a business plan and budget	The SOE should consider whether the initial business plan and budget should form part of the bidding requirements of the asset recycling transaction and part of the evaluation of the same. The initial business and budget of JVCo could then consist of the proposed business plan and budget included in the bid of the winning bidder / appointed private investor if acceptable and suitable to the SOE. Subsequently, the Executive Team would typically put together a draft business/working plan and budget for each financial year for the BOD's approval which is expected to be consistent with the initial (long term) business plan and budget.
15.	Initial Funding and Contributions	Requirements for initial contributions to the business	The SOE to consider whether each shareholder (including itself or relevant affiliate) shall be required to contribute an initial amount of working capital or assets to JVCo. The respective shareholder capital contributions versus their shareholding as well as their relative ability to control the day-to-day and overall business of JVCo will be critical to the assessment of the asset recycling transaction made by private investors at bid stage and have a direct impact on valuation and the upfront fee they may be willing to pay. The SOE should also consider whether: • Shareholders are to make contributions to JVCo in cash or in kind; • how are contributed assets to be valued? How will any adjustments be made for any shortfall or excess in relation to any parties' proportionate funding obligation resulting from the valuation of the assets contributed?

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16.	Further Funding	Process and mechanisms where further funding is required	The SOE should also determine the obligations of the respective Shareholders where further funding is required during the term of the asset recycling transaction and agreement, and whether and to what extent it (or its relevant affiliate) will contribute to such funding. As a general principle, Shareholders shall ensure that JVCo has sufficient working capital to conduct the Business either from: • loans from the Shareholders to JVCo; or • borrowings by JVCo, which may be unsecured or secured by assets of the JVCo; supported by guarantees from the Shareholders. If third party finance is being raised, who will be responsible for arranging this? Will this be guaranteed (jointly or severally) by the Shareholders (or any of them)? Should lenders have recourse beyond the assets of the JVCo? The SOE should also consider what arrangements should be made in the event that a Shareholder fails to provide further funding when due (e.g. default/dilution provisions).
17.	Dividend Policy	How and when dividends are to be declared and allocated	The SOE should also consider how and when dividends are to be declared and, more importantly, how dividends are to be shared amongst the Shareholders including itself (or its relevant affiliate). The private investor(s) will typically expect that there is some degree of balance and correlation between the obligations of the Shareholders to contribute to the funding of JVCo and their entitlement to dividends.
Other key issues			
18.	Reports	Determine what reports the Shareholders shall be entitled to receive from JVCo	The SOE should consider what type of reporting and information it wishes to receive on a continuous basis from JVCo. Typically, the Executive Team willl prepare and provide the BOD and the Shareholders with monthly/quarterly management reports.

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19.	Conflicts of interest and non-compete	Determine whether there are risks of conflict of interest or competing assets/activities	The SOE should determine whether there may be existing or potential risks of conflict of interest between any Shareholder of JVCo (including itself or related entities) and JVCo and the Business. Related to this is the risk of any assets/activities which are or may compete with the Business of JVCo and which are controlled by any of the Shareholders (including the SOE) or any related entities. The SOE should consider whether and to what extent the Shareholders will be prohibited from competing with the JVCo, and if so, what territorial or other limitations should apply, and for what period? The risk of conflicts of interest and/or competing assets/activities may have a material impact on valuation and the attractiveness of the asset recycling transaction for private investor(s) as these could potentially (depending on the nature of such conflicts of interest and/or competing assets/activities) affect the revenue generation of the Asset and required return on investment of the private investor(s).
20.	Restrictions on transfer of shares in JVCo	What restrictions apply to the transfer of shares in JVCo	The SOE should determine whether and to what extent the Shareholders (including itself and/or the private investor(s)) will have the right to deal, transfer or otherwise dispose of any interest in their shares to a third party. This may involve a certain lock-in period during which the Shareholders (or just the private partner) may not transfer their shares/divest their interest in the JVCo to ensure that the partner which will have been selected pursuant to the asset recycling partner procurement process, does not exit the Asset and JVCo at an early stage. In any event, any material transfer of shares by a Shareholder should (typically) only be allowed to a qualified third party which fulfils certain agreed requirements (for example, financial capability or experience) or subject to prior approval of the other Shareholder(s). Certain other typical rights of Shareholders in the event of a transfer of shares/sell down to be considered by the SOE include providing for: • A first right of refusal; and/or • drag along or tag along rights;

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21.	Shareholder loans	Mechanism for dealing with shareholder loans to JVCo	Shareholder loans to JVCo should be on arm's length terms. The SOE should also consider whether such loans should be convertible into shares or not (for outstanding amounts which have not been repaid by JVCo within a certain timeframe).
22.	Restriction on encumbrance over shares and JVCo's assets	Whether there will be specific restrictions on encumbering shares or assets of JVCo	The SOE may want to consider including provisions in the SHA related to restrictions on the encumbrance of shares held by any Shareholder and JVCo's assets, as well as on JVCo providing any guarantees over any third party's financial liability.
23.	Events of default	Events of default and consequences of breach	The SOE should consider the types of Shareholder default which should be reflected in the future SHA (and AoA of JVCo). These may include the following: • a Shareholder being insolvent; • breaching a material term of the SHA; • purporting to dispose of or encumber shares in JVCo other than as permitted under the SHA; • a Shareholder undergoing a change of control without the approval of the other Shareholders. The detailed process for dealing with events of default, including appropriate checks and balances, will be covered in the SHA.
24.	Governing law and Dispute Resolution	Governing law of SHA and dispute resolution to be determined	The SOE to consider the governing law of the future SHA. In terms of the dispute resolution mechanism applicable to any disputes amongst Shareholders and the ultimate dispute resolution forum (jurisdiction), private investor(s) will have a strong preference (if not requirement) for any disputes to be finally settled in international arbitration (as opposed to the courts). The contrary might constitute a deal breaker for most international investors.

Related Content

- **Guidelines for Implementing Asset Recycling Transactions (Download PDF version)**

Additional Resources

- Joint Ventures and Government Shareholding in Project Companies
- PPP Legal Framework

This section has not been prepared with any specific transaction in mind and are meant to serve only as general guidance. It is therefore critical that the content will be reviewed and adapted for specific transactions.

This is a new section of the website and is currently in draft form. For feedback on the content of this section or to suggest additional links or materials, please contact the PPP Resource Center using the feedback form.

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