

Feature

KEY POINTS

- ▶ The requirement that the joint venture (‘JV’) parties must act with diligence and care to establish the JVCo may seem trivial, but is actually quite important.
- ▶ To the extent a non-local party relies on a local party, the ‘diligence and care’ requirement provides important contractual protections for the non-local party.
- ▶ Today, it is uncommon to specify anything other than unlimited duration for a JVCo, even where the JV parties contemplate that the JV will have a finite life.

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Joint venture agreements: part 4 – establishing the JVCo

JVA art 3.1 sets out the parties’ obligations to establish the JVCo. It covers three concepts: First, the JV parties must ‘act with diligence and care to establish’ the JVCo. Secondly, they must do so ‘as soon as practicable’. Thirdly, they must do so ‘in accordance with [the JVA] and all Regulatory Approvals’.

The requirement to act with diligence and care may seem trivial, but is actually quite important. Prior to establishing the JVCo, the JV parties act at arm’s length from each other in negotiating the JVA and performing their obligations under the JVA. Each party usually has its own legal counsel. There is often no separate counsel acting for the JV until the JVCo has been established and its board appointed or its executive team in place. In the

This article is fourth in a series examining project development and finance joint ventures (‘JVs’) based on the International Trade Centre incorporated joint venture model agreement among three or more parties.¹ This instalment addresses the parameters for establishing the joint venture company (‘JVCo’), as covered in art 3 of the model joint venture agreement (‘JVA’).

where the JVCo will be incorporated must either rely heavily on the local parties, hire their own local counsel, or convince the local parties to share the cost of hiring local counsel for the JV. To the extent a non-local party relies on a local party, the ‘diligence and care’ requirement provides important contractual protections for the non-local party against mistakes made and/or deliberate misdeeds of the local party and its advisers.

incorporate the JVCo if the JV wins the tender process, then art 3.1 of the JVA should be modified to reflect this.

The third requirement in art 3.1, to establish the JVCo in accordance with the JVA and all regulatory approvals, has two subcomponents. Establishing the JVCo in accordance with the JVA ensures again that any party taking individual responsibility for the JV parties as a group must ensure that the JVCo is established consistently with the requirements stipulated by the parties. For example, where more than one type of entity may be incorporated in the relevant jurisdiction, the responsible party must incorporate the type of entity designated by the parties, including ensuring that it has made all relevant designations and elections to relevant government authorities (such as elections whether or not to be treated as an entity with relaxed filing and reporting requirements, perhaps by electing to be treated as a ‘closely held’ entity, or elections as to whether the entity will be separately taxable or will be considered a pass-through entity with all tax calculated and imposed at the JV party level). Though often mechanical and perfunctory in nature, such elections and designations can have far-reaching negative consequences if not properly or timely made.

The requirement to establish the JVA in accordance with regulatory approvals further ensures that each party with any responsibility for the documentation or incorporation process is obligated to comply with the agreed and

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interim, legal, financial and other professional advice for the JV is usually obtained from professional advisers who have been retained by a JV party and who owe their duties solely to protecting the interests of that party.

The ‘diligence and care’ requirement thus ensures that the JV parties, and counsel acting on their behalf, have an express contractual obligation to act in the common interest. For example, to incorporate the JVCo, one party’s counsel may prepare or finalise the formal constitutional documents to be filed in the relevant jurisdiction. Where one or more parties are located in the jurisdiction where the JVCo will be incorporated, counsel for a local JV party will often be asked to draw up the relevant documents, subject to review and approval by the other JV parties and their counsel. Those JV parties who do not customarily do business in the jurisdiction

The second requirement in art 3.1, to incorporate the JVCo as soon as practicable, is similarly useful in protecting the other parties where one party assumes responsibility for handling the incorporation, by requiring that party to complete the process with dispatch. It also imposes obligations on all the parties to act with due speed, and not to unreasonably delay or withhold approval of the acts and deeds undertaken by another party on behalf of the JV.

However, the parties may need to modify the art 3.1 ‘as soon as practicable’ requirement to accommodate situations where they have agreed to delay incorporation of the JVCo until the occurrence of a specified condition precedent. For example, as mentioned in an earlier instalment of this series, in cases where the JV is participating in a competitive process for the award of a licence, contract or concession, and the parties intend only to

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necessary regulatory process. Article 1 of the model JVA rather simply defines 'regulatory approvals' as 'governmental or regulatory approvals required by the Parties for the establishment' of the JVA. This definition plainly includes those regulatory approvals required to incorporate the JVCo in the relevant jurisdiction, such as presenting all the requisite incorporation documents and the appropriate filing fee to the proper authorities, and such things as permission to make a foreign controlled investment in those jurisdictions that impose foreign ownership restrictions, which sometimes requires pre-approval of the incorporation documents.

More subtly, the definition of regulatory approvals also includes other regulatory approvals required by the parties as conditions precedent, concurrent conditions and/or subsequent conditions. These might include, for example, submitting a copy of the JVCo incorporation documents to the government authority issuing the licence, concession or contract which was awarded to the JV.

The JV parties and their counsel must also pay close attention to compliance with the vagaries of local law regulating the incorporation and activities of the specific entity chosen for the JVCo. These might include such matters as maximum or minimum numbers of shareholders, limits on the types or residence of shareholders or the percentage of foreign ownership, requirements as to minimum or maximum number of directors, residency or citizenship of directors, whether entities (as opposed to individuals) may serve as directors, restrictions on share types (eg, whether preferred or preference shares are permitted), and so forth.

Article 3.2 of the model JVA specifies the jurisdiction where the JVCo will be incorporated. In many projects, this is straightforward, and will simply be where the JV project is located. However, in some cases, the JV parties may choose to incorporate elsewhere, and conduct business in the project country as a branch. As discussed in an earlier instalment, the JV parties may also sometimes form an intermediary JVCo in one jurisdiction and then form a wholly owned JVCo subsidiary in the project jurisdiction. The issues will be the same, but will require

compliance with two separate sets of entity laws. The model JVA does not provide a clear place to specify the type of entity to be used for the JVCo. This can be handled by adding a separate sub-article to art 3 or by adding the entity type to art 3.2.

Article 3.3 specifies the 'seat' of the JVCo. This somewhat quaint term, which is sometimes used in Europe and elsewhere, usually refers to the domicile of an entity. As discussed above, the domicile of the JVCo will typically be where the project is located, and, unless the JV parties incorporate the JVCo in a different jurisdiction, will usually also be the jurisdiction where it is incorporated. In some cases, the seat of a company is considered to be where its management is located.

Article 3.2 also specifies the registrar with whom the incorporation documents will be filed. That decision typically follows directly

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from the choice of entity and jurisdiction of incorporation. Additional filings may also be required where the JVCo will conduct business in a jurisdiction other than that in which it is incorporated. For example, a JVCo operating a tunnel, bridge or ferry connecting two different jurisdictions may be incorporated in one and qualified to conduct business in the other. These decisions are usually driven by regulatory, tax and other considerations.

Article 3.4 requires the parties to specify whether the JVCo will have unlimited or finite duration. Today, it is uncommon to specify anything other than unlimited duration for a JVCo, even where the JV parties contemplate that the JV will have a finite life. For example, the JV parties may sell the shares or assets of the JVCo at the end of the JV, so having the JVCo continue in existence indefinitely is useful in allowing its shares to be sold and its continued existence following an asset sale enables it to stand behind representations, warranties, indemnities and other covenants. Where a JVCo is a special purpose vehicle to perform a government licence, concession or contract, the licence, concession or contract

might be extended, making it convenient if the entity has unlimited duration. Even where a JVCo's useful existence has been reached, the JV parties can in most jurisdictions follow a simple statutory winding-up procedure to dissolve the JVCo.

Article 3.5 specifies the share capital, the number of shares into which it will be divided and the par or face value per share. The concepts of par value, stated capital, capital surplus and earned surplus were developed in the early days of limited liability companies to protect creditors who dealt with those companies by requiring a specified minimum amount of stated capital and generally prohibiting any withdrawal or intentional impairment of capital for as long as the company traded. Time has long since proved that the concept of stated capital is anachronistic, and provides little

or no protection to creditors, who are better protected through privately negotiated and enforced disclosures and financial covenants. Nevertheless, stated capital requirements persist in many jurisdictions.

In addition, where a JV party will receive shares for property (other than cash) or services, some jurisdictions require compliance with a statutory valuation procedure to ensure that the JV party pays the full stated value for its shares. Counsel for the JV parties and/or JVCo will thus need to ensure compliance with such requirements, but they otherwise have little or no significance to the JV parties.

In conclusion, art 3 covers a range of seemingly bland topics, some of which are nevertheless quite important for the JV and the JV parties. Counsel's task is to understand these provisions, educate the clients, and ensure that they are appropriately applied in the formation of the JVCo. ■

The model JVA discussed may be found at www.jurisint.org/doc/orig/con/en/2005/2005jiconen1/2005jiconen1.pdf.