

Feature

KEY POINTS

- Although art 21 appears to be a relatively straightforward winding up provision that will apply if the Joint Venture parties decide to end their JV, there are some weaknesses and flaws in the model Joint Venture Agreement that will need to be corrected by lawyers for the JV parties.
- Article 21 does not address circumstances where the JV among the JV parties ends but the JVCo itself continues in business.
- It contains several provisions that may run afoul of the duties of the JV parties to the JVCo's creditors.

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Joint Venture Agreements: part 15 – ending the JV

Article 21.1 of the model JVA provides that the JV will come to an end either if the JV parties agree to end it or if an arbitral tribunal decides to end it. The remainder of art 21 is devoted to setting out the procedures and substantive rules for winding up the JVCo, the rights and obligations of the JV parties in respect of the JVCo and its assets, and their rights and obligations with respect to each other that survive the end of the JV. The reader will recall that art 3.4 of

This article is 15th in a series examining project development and finance joint ventures ('JVs') based on the International Trade Centre incorporated joint venture model agreement ('JVA') among three or more parties.¹ This instalment focuses on JVA art 21, which addresses when and how the JV will come to an end and the joint venture company ('JVCo') will be wound up, and the consequences that flow from those events.

business in order to create a liquidity and exit event for one or more of the JV parties. Purely financial investors in a project JV often seek to have a liquidity event after a

or a right of first refusal. Such a sale may or may not end the JV, as opposed to simply changing the JV parties, but will typically not wind up the JVCo.

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the JVA specifies that the duration of the JVCo is perpetual. Indeed, other than art 21, the model JVA does not even contain a termination provision (although the lawyers for the JV parties may want to add one to cover those circumstances where the JVCo will continue in business but circumstances have made it appropriate for the JVA to terminate). Article 21 thus only applies when the parties decide, or an arbitral tribunal decides for them if they cannot agree, that notwithstanding art 3.4, circumstances have arisen that make it advisable or necessary to end the JV and wind up the JVCo.

Before moving on to these circumstances, and how the JVCo is to be wound up, however, the reader should first consider some of the alternatives to winding up the JVCo that may be more appropriate in certain circumstances in which the JV ends.

One scenario involves the sale of the JVCo or its assets as a going concern

specified holding period as a way to exit and realise the capital gains on their investment. Such rights are often expressly set out in a clause entitling the holders of a specified percentage of the JVCo's shares to force the sale of all the shares or all the assets of the JVCo. This may involve a sale by the exiting JV parties of their JVCo shares to an arm's length purchaser. Such a sale would, of course, end the JV, but not in the manner contemplated in art 21. And it would not wind up the JVCo, but rather change its owners.

On the other hand, some JV parties, such as those in a similar business or its entrepreneurial founders, may prefer to hold their investments in the JVCo for a longer term than purely financial investors. Thus, where financial investors have the right to force a sale, the other JV parties may have an option to buy them out. This could be based on a specified price, a procedure for determining a fair price, a right of first offer,

Even where such events are not expressly provided for in the JVA, if JV parties holding a majority of JVCo shares want to exit, they may be able to force a sale of all the assets of the JVCo to an arm's-length purchaser. If a share sale is preferable, for tax or other reasons, the majority may be able to sell their JVCo shares, while leaving the other JV parties behind as minority shareholders alongside the new owners. The provisions of art 15, discussed in a previous instalment, address the procedures that must be followed when one group of JV parties wants to sell its shares and other JV parties do not. If the purchasers accede to the JVA, then such sales may not necessarily bring the JV to an end, but they will certainly change the complexion of the JV. Also, in a share sale, the JVCo will typically continue in business.

Even absent such a liquidity and exit event, the JVA may be terminated voluntarily by the JV parties (or their successors) without the JVCo being liquidated or wound up. For example, if the JVCo becomes independent of the JV parties and self-supporting, then the JVA may no longer be useful or appropriate as a governance document and the JV parties simply terminate the JVA or provide in advance for it to expire. The model JVA

contains no such provision. Any such expiration of the JVA would not require the JVA to be wound up.

We will now turn to those circumstances under which the JV will end *and* the JVCo will be wound up. As mentioned in art 21.1(a), these steps are likely to be taken if the JV's 'objectives have been realised' or 'have become impossible to realise'. If the JV's objectives have been realised in the sense that the JV parties have established a profitable and successful business enterprise, then, as discussed above, this would hardly merit winding up the JVCo even if the JVA is terminated (unless the business is sold in an asset transaction). The drafters of the model JVA more likely had in mind a scenario in which the JV has completed the life of the project for which the JVCo was established as a special purpose vehicle, and the JV has no further business purpose. This may be the case where the JVCo operated under a build-operate-transfer concession and the time to transfer the project facility to the government or other beneficiary has arrived. It may also be the case where the JVCo had a licence, concession or contract of finite duration, and it has come to an end and not been renewed.

The other scenario contemplated by the model JVA's drafters, that of impossibility to realise the JV's objectives, could arise under a variety of circumstances. For example, the JV may have tried and failed due to unanticipated market conditions or circumstances that simply make the business of the JV unprofitable and unlikely ever to be profitable. On the other hand, even if the market for the JV's business was good, the JV may have been prevented from realising its objectives due to an extended *force majeure*. Though art 17 addressed the removal of a JV party due to such a *force majeure*, it is also possible that a *force majeure* will block the ability of the entire JV to pursue its objectives. In the case of a project JV, such events could include military conflict or civil unrest, cataclysmic decline in the economy of the host country or other such factors that make the project pursued by the JV no longer viable.

Article 21.2 provides that, if the JV is ended, the JV parties will proceed to wind

up and dissolve the JVCo. This involves several steps. First, under art 21.2(a), the JV parties must terminate the JVCo's legal relationships with third parties. In the case of a licence, concession or contract with a government authority, the JV parties may have committed, backed by their own guarantees of performance, to continue the JVCo's business for a specified term of years or until a specified goal is achieved. Ending the JV before such milestone is met can be

problematic. It will likely require consent of the government authority, and may subject the JV parties to financial or other penalties. The JV parties will also need to make similar arrangements for the early termination of the JVCo's other contracts.

Secondly, under art 21.2(b), the JV parties must cause the JVCo to liquidate its assets. They can be sold to arm's length purchasers, perhaps relinquished to the governmental authority that granted the licence, concession or contract as part of the settlement for early release, or even sold to one or more JV parties. The model JVA affords any JV party that contributed assets in kind to the JV (such as land, buildings, machinery, equipment or intellectual property) a right of first refusal to reacquire those assets in the liquidation.

While such a right sounds fair, it can wreak havoc on the ability of the JV parties to ensure an orderly and successful liquidation of the JVCo's assets. The JV party who contributed in kind may cling to its right of first refusal, perhaps to gain leverage in negotiations with the other JV parties. Yet, the JVCo's assets, if dismembered rather than sold as a going concern or assembled project, may have substantially less value. The whole may indeed be greater than the sum of its parts, and one JV party should not be afforded the right to block the sale of the whole.

Thirdly, under art 21.2(c), the JV parties must cause the JVCo to settle its debts. These would include both liquidated claims of creditors, such as banks that may have lent money to the JV or vendors who supplied materials and services but have not yet been fully paid, and unliquidated claims such as those for breach of contract that may be made by any counterparty whose contract with the JVCo has been terminated early.

Where the available cash after

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liquidation of the JVCo's assets is insufficient to satisfy all the legitimate claims of its creditors, payments will need to be made in accordance with the relative priorities of the JVCo's creditors under applicable law. Certain tax and other authorities will likely be entitled to be paid first. Next in line will be secured creditors to the extent of the value of their collateral. After secured creditors will come unsecured creditors. To the extent the JV parties, as among themselves, consider the JVCo to have obligations to repay any moneys as debt (rather than equity), these debts will in most jurisdictions be subordinated to all other creditors.

Thus, as a fourth step, art 21.2(d) provides for the JVCo to refund any JV party loans (after payment of all other creditors). In addition to loans, which are expressly mentioned in art 21.2(d), this step should also include payment of any other debts of the JVCo to the JV parties. For example, if a JV party had contracted to provide services to the JVCo in exchange for payment, then any sums due to the JV party for such services, or even for breach of such contract through early termination, would be addressed in this step of the liquidation and winding up process.

Finally, as a fifth step, art 21.2(e) provides for the JV parties to cause the JVCo to distribute any remaining assets

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in the JVCo to the JV parties according to their percentages of equity in the JVCo. Depending on the complexity of the JVCo's capital structure, such as having different classes of equity, this step may need to be further subdivided.

At the end of art 21.2, the model JVA also provides for the possibility of two or more JV parties taking over the JVCo's assets and activities at the end of the JV. This is a permutation of the previously discussed scenario in which some JV parties want to exit while others do not. It is thus better addressed though the types of

and reasonable, but is actually problematic. The JVCo's intellectual property comprises part of its assets that must be marshaled and liquidated under art 21.2(b) (and indeed under applicable law in most jurisdictions). Unless the JVCo's other assets are sufficient in value to provide for payment of its debts, the intellectual property must be sold, licensed or bartered to raise funds to pay creditors. It is possible that the creditors will allow the JV parties to secure a non-exclusive licence, in return for payment of royalties. But the JVCo's creditors are otherwise unlikely to permit the JV parties

will still require JV party approval. This provision, in some ways, drifts even further afield from the paramount duty to discharge the JVCo's debts. It then delves into the issues just discussed in the preceding paragraph as to the ownership of the intellectual property and the respective rights of the parties to use and reap the benefits of it.

Article 21.4 concludes by indicating those few provisions of the JVA that will survive termination of the JV. It identifies three. First, art 21 itself will survive. Also, any rights or obligations that have accrued prior to the end of the JV are preserved. To the extent that these are rights and obligations between the JVCo and a JV party, they will be dealt with as assets and liabilities of the JVCo in the liquidation waterfall. To the extent they subsist between or among JV parties, they will be preserved as contract claims and obligations to be sorted or adjudicated in accordance with the JVA. In addition, art 21.4 preserves the rights and obligations of the JV parties under the confidentiality clause of the JVA. This contrasts with art 21.3, which ends duties of loyalty to the JV or JVCo.

In conclusion, art 21 appears to be a relatively straightforward winding up provision that will apply if the JV parties decide to end their JV. However, it does not address circumstances under which it continues in business. Moreover, it contains several provisions that may run afoul of the duties of the JV parties to the JVCo's creditors, that may undermine the ability of the JV parties to maximise their gains (or minimise their losses) on termination of the JV and that may otherwise set in motion post-termination arrangements that have not been fully thought through and developed. Lawyers for the JV parties will need to consult with their clients about these scenarios and endeavour to correct these weaknesses or flaws in the model JVA when negotiating and drafting the JVA for their clients. ■

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provisions that deal with exits than in the context of the winding up provisions of art 21.

Art. 21.3 sets out certain agreements among the JV parties that spring into effect when the JV ends. First, under art 21.3(a), each JV party is permitted to carry on in the same business as the JVCo did. This clarifies that the non-competition clause and duties of loyalty to the JV have ended, and that the JV parties are expressly permitted to pursue any business opportunity without accounting to the other JV parties. This provision, while seemingly fair as among the JV parties, may run afoul of the duty of the JV parties to ensure that the JVCo's creditors are paid in full. It may also undermine the ability of the JV parties to realise the best price for sale of the JVCo's assets, where the purchaser may expect undertakings not to compete with the business of the JV from the JV parties, and hence encroach on the potential proceeds that may be available for distribution to the JV parties after payment of the JVCo's debts.

Second, under art 21.3(b), each JV party will have a non-exclusive right to use the JVCo's intellectual property. This provision at first blush appears to be fair

to take its intellectual property, free of charge, unless and until they have been paid in full.

Apart from the issue of payment of creditors, art 21.3(b) is also ambiguous as to who owns the intellectual property after the JVCo is wound up. It is possible that the intellectual property would be jointly owned, in perpetuity, by the JV parties as tenants in common, with each having an unfettered right to use and improve the intellectual property without having to account to the others. However, such an arrangement is problematic in terms of defending and enforcing the intellectual property rights against third parties. If one JV party is more qualified than the others to be a steward of the intellectual property, then it may be better to vest ownership in that JV party and have the remaining JV parties enjoy a non-exclusive, paid-up licence to use the intellectual property. One would still need to address typical matters between licensors and licensees regarding protection and enforcement of the intellectual property against infringement or misappropriation, including any cost sharing arrangements.

Third, art 21.3(c) provides that commercial exploitation of the JVCo's intellectual property after the JV ends

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