Feature

KEY POINTS

- A joint venture agreement for a project joint venture must address many and varied issues of significance.
- This first instalment in a multi-part series surveys the primary elements of an incorporated joint venture ('JV'). Subsequent instalments will work through a model joint venture agreement in detail.

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Joint venture agreements in project development and finance: an introduction

This is the first instalment in a multi-part series that examines issues typically addressed in a joint venture agreement ('JVA') for a project development and finance transaction. This series should interest readers involved in project finance, whether in equities or secured lending.

Many projects involve a special purpose project entity ('JVCo') owned by several active and passive JV parties who contribute cash, property and/or services, with project lenders providing the senior debt, and the JV parties possibly providing subordinated debt. A JVA typically sets out the arrangements among the parties. The discussion in the subsequent instalments of this series will use the International Trade Center ('ITC') incorporated joint venture model agreement for three or more parties.[1]

In this instalment, we will survey the primary elements of an incorporated joint venture, and highlight some major issues that need to be addressed. In subsequent instalments, we will work through the model JVA in detail.

A JVCo is usually by definition a start-up entity established by one or more JV parties who join forces to pursue a defined project.[2] Joint ventures are common in major infrastructure projects in such sectors as transport (roads, bridges, tunnels, railways, seaports, airports), energy (power plants, pipelines, extraction facilities, refineries), telecom (mobile networks, undersea cable networks, satellite networks) and real estate (hotels, office parks, entertainment complexes).

This discussion will consider, as an example, a bidding team for a mobile telecom licence in a single-country market that is opening up one additional network licence. Applicants will be required to demonstrate that they meet certain minimum qualifications (many of which have implications for the joint venture arrangements), and then the licence will be awarded to the highest bidder in an auction conducted among all qualifying applicants. The example discussed here could as easily be for an independent power project, a toll road construction tender or any other substantial infrastructure project where the roles of project management, procurement, installation, operation, maintenance and financing are carried out by different parties brought together for the project.

The JV parties comprising the bidding team in our example include: (i) a project development company whose business is to identify project development opportunities and form and manage bidding teams to compete for them; (ii) an international telecom network operator with experience in other markets (whose participation is a prerequisite for the bidding team to qualify); (iii) a local business partner in a complementary business (in this case, a retail electronics business that may serve as a distribution channel for handsets for the mobile licensee); and (iv) several passive financial investors to provide the remaining equity capital for the business.

The JV parties in our example will enter into a JVA before submitting their bid, and will jointly fund or otherwise contribute to the cost and effort of preparing and submitting the bid, but will not establish or fund the JVCo unless their bidding team is awarded the mobile telecom licence. As is evident from the description of the JV parties, each will make a different contribution to the prospects of the bidding team being awarded a licence and each will be expected to provide different resources to the JVCo if they are awarded the licence and set up the JVCo. The JVA will need to contemplate these varying roles and contributions.

The major issues the JVA must address include the nature, timing and extent of each JV party's contributions to and withdrawals from the venture, and a governance structure for the relationship among the JV parties and JVCo. Some JV parties may simply contribute cash, while others may contribute know-how, access to markets or personnel. Some JV parties may only withdraw dividends from earnings and profits of the JVCo, while others may be paid for services or property contributed.

A threshold issue is to define clearly the objects and scope of the joint venture. Many of the rights and obligations of the JV parties will turn on the scope of the venture. One typical attribute of a joint venture is its relatively narrow and precisely defined scope, in contrast with a start-up formed to engage in 'any lawful business'.

In our example, the pre-incorporation obligations of the JV parties relate primarily to preparing and submitting the bid for a mobile telecom licence. These obligations include supplying information about the parties as required for the bid, preparing a business plan and technical plan for the financing, building, operation and management of the proposed telecom network, and paying the agreed portion of the joint legal, consulting, investment banking and accounting expenses for the bidding team.

The JVA will also govern the establishment, capitalisation and operation of the JVCo, which will be incorporated if and when the bidding team wins the licence. The licence application will typically require the JV parties to submit drafts of the proposed constitutional documents of the JVCo. These documents will contain the provisions dealing with most of the issues discussed in this article. The government authority reviewing the applications and qualifying the applicants generally seeks to confirm that the JVCo's constitutional documents are consistent with the representations made in the application.

The JVA will set out each JV party's expected contributions to the JVCo. Collectively, these contributions will be intended to supply

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all cash equity capital and in-kind contributions contemplated in the business plan. The JVA will also provide for any additional funding of the JVCo that may prove necessary if the initial commitments are inadequate, and for any guarantees of bank debt and other obligations of the JVCo by the JV parties. These commitments are not necessarily symmetrical or proportionate to the percentage of equity held by each JV party. For example, the telecom operator JV party will likely be expected by the licensing authority to make contractual commitments to the JVCo and/or directly to the licensing authority regarding its contribution of know-how and telecom management expertise. The licensing authority requires the inclusion of a telecom operator JV party in the bidding team to increase the likelihood of success of the JVCo in meeting the requirements of the telecom licence (such as geographic and population coverage for the network, quality of service commitments to customers and other such terms).

The JVA will also set out how the JVCo will keep its financial accounts, and make provision for mandatory dividends and other distributions of profits to the JV parties to the extent funds are available for such payments consistent with the business plan.

The JVA will set out the governance procedures for the joint venture, including the division of authority among the shareholders, board of directors and executives of the JVCo. Some fundamental decisions may require supermajority or unanimous approval and/or trigger certain exit or non-participation rights by non-approving JV parties. These might include, for example, a decision to make a capital call to expand the scope of the JVCo's business plan to include a type of service or technology not contemplated in the original business plan.

In addition to capital contributions, some JV parties may be entitled or expected to provide management, outsourcing or other services to the joint venture. In our example, the project development company may provide pre-licensing services to the consortium during the bidding process, and may be entitled to compensation from the other JV parties for such services (such as equity participation in the venture at a reduced price and/or a success fee).

The international telecom operator in our example may be expected to enter into a management agreement to provide start-up management services to the JVCo and, as is often required by the telecom licensing authority, to provide ongoing management services to the JVCo during an initial period of years. The international telecom operator may receive a management fee for such services based on a percentage of revenues or some other formula. In addition, such JV parties typically want to limit the amount of total equity capital they invest in a licensee JVCo, so may be capped on their required equity contribution, with the other shareholders making up any pro rata shortfall through subordinated debt or other mezzanine finance (as the licensing authority usually requires the telecom operator to own a minimum percentage of fully funded equity).

The electronics dealer in our example may also have an agreement with the JVCo to provide an initial distribution channel for the handsets and telecom services offered by the JVCo (on an exclusive or non-exclusive basis).

The JVA will provide for any contemplated secondment of employees by JV parties to JVCo, and any transfer or licensing of intellectual property by JV parties to JVCo. This might include, for example, co-branding by the JVCo with one or more JV parties. It might also include any transfers of know-how and network design services by the international telecom operator or any equipment manufacturer or network design firm that participates as a JV party.

The licensing authority will usually require a lock-up of the telecom operator's shares for some extended initial period (usually co-extensive with the term of the management agreement), to ensure that the operator stays around and interested long enough to ensure the viability and success of the licensee. Other shareholders of the JVCo may be permitted to transfer their shares at any time, but such transfers may require pre-approval by the licensing authority – to ensure that any change in control will not result in the licensee no longer being qualified. Pre-approvals of transfers of significant blocks of shares or to specific transferees is also usually required by the telecom licensing authority to ensure enforcement of any cross-ownership restrictions with other telecom licensees.

The JVA will usually also address other share transfer issues (subject to any required regulatory approval), such as voluntary exit by a JV party (for example, in connection with the sale of its business) and forced exit of a JV party (where, for example, a JV party fails to meet its obligations to the other JV parties or suffers an insolvency or other disqualifying event).

Similar issues will need to be addressed regarding post-licensing entry of new parties to the joint venture or issuances of shares by JVCo to new parties or to existing parties on a non-pro-rata basis.

Finally, the JVA will usually set out the agreed duties of loyalty by the JV parties to JVCo and each other. Here, the specific and limited scope of the joint venture is used to narrowly tailor these duties. For example, the international telecom operator may agree not to participate in any other telecom activities in the geographic market of the JVCo, but may also be free to engage in any telecom-related activities without restriction in all other markets.

As this introductory instalment indicates, a JVA for a project joint venture must address many and varied issues of significance. Over the coming instalments, we will delve into each topic and consider its sub-issues in greater detail. ■

1 The model JVA discussed in this series may be found at www.jurisint.org/doc/orig/con/en/2005/2005jiconen1/2005jiconen1.pdf. The ITC also has model agreements for a two-party incorporated joint venture, and two-party and 3+-party unincorporated joint ventures. We have chosen the incorporated form because that is more commonly used when a special purpose vehicle will be employed as a project entity and 3+ parties because it is a more complex situation and one that is frequently encountered. Unincorporated joint ventures, which are more commonly used among teams of contractors, designers and engineers in construction projects and in the design and development of major product prototypes, are beyond the scope of this series of articles. The model JVA was published in 2005 by the International Trade Centre, a joint agency of the World Trade Organization and the United Nations Conference on Trade and Development, as a collaborative work product of practitioners in some 50 countries.

2 Some project joint ventures involve equity participation by the public sector, which raises special issues that are not considered here.