Joint Venture Toolkit

Guidance Note: Common terms in incorporated joint ventures

Australian Government
National Indigenous Australians Agency

Waalitj Hub
WA INDIGENOUS BUSINESS AND EMPLOYMENT HUB

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Background

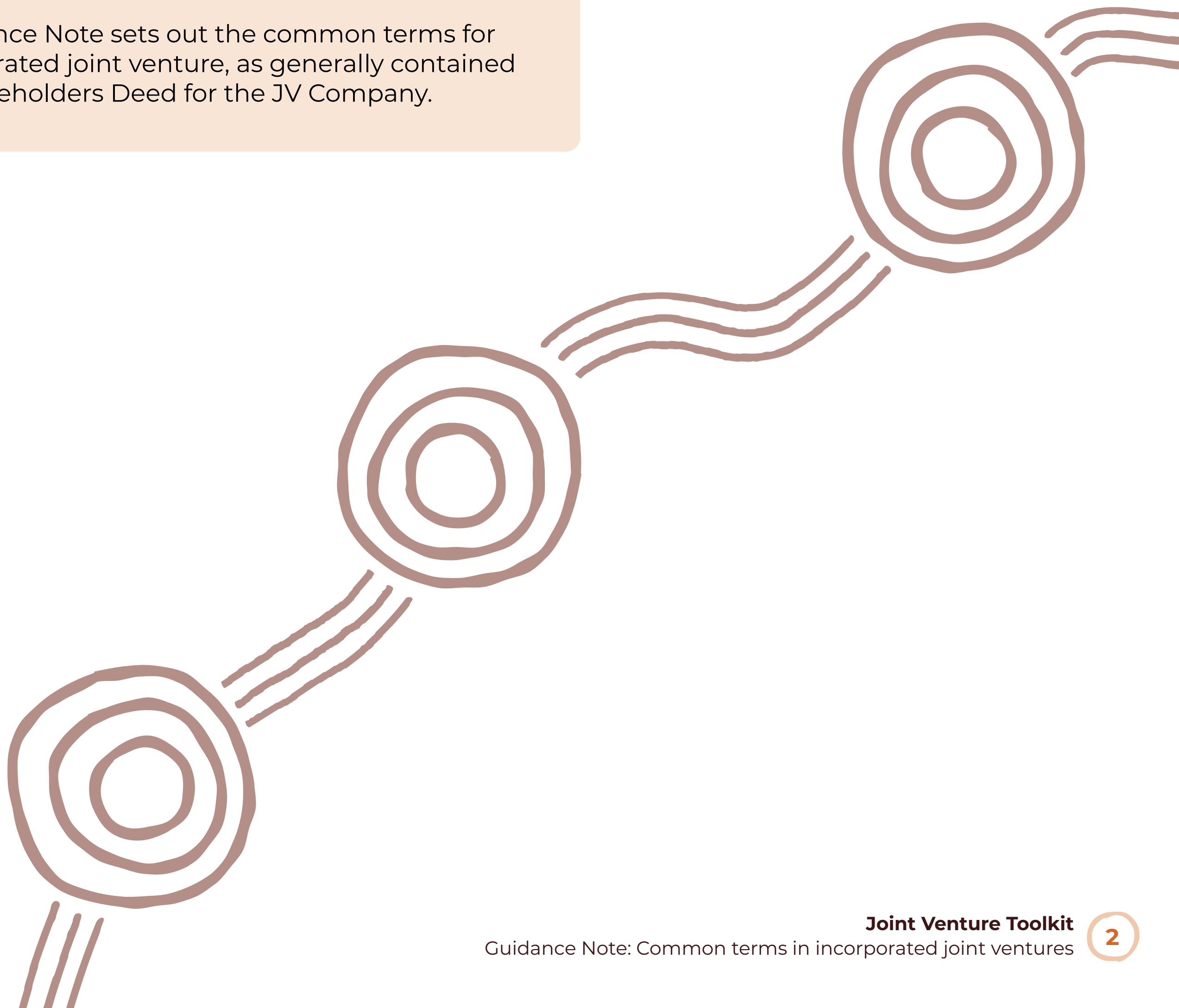
An **incorporated joint venture** is where two or more parties collaborate to pursue an opportunity through a company owned by the joint venture parties. Each party holds shares in the joint venture (**JV**) company in proportion to their ownership stake in the joint venture. For more information about incorporated joint ventures, see "Guidance Note: Different structures for joint enterprises".

Joint venture participants are often laser-focused on business objectives and may not necessarily have considered what might occur if the JV company's shareholders disagree on important issues. While the relationship between a company's founder and its initial investors will usually be very collaborative at first, there are a many examples of relationships breaking down and eventually leading to expensive and time consuming disputes.

Shareholders deeds outline how a company will be controlled and managed. To be effective, a company's shareholders deed should be tailored for the relationships between its shareholders, the objectives and strategy of the company, the Indigenous participation objectives and industry-specific matters. It must also identify the potential areas for disagreement, and ways to resolve those disagreements, within the context of the company's business and its shareholders.

A well-prepared shareholders deed appropriately balances the rights and interests of the parties. It often covers a wide range of matters, including the matters outlined in this guidance note.

This Guidance Note sets out the common terms for an incorporated joint venture, as generally contained in the Shareholders Deed for the JV Company.



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Common Terms

1. Purpose or objects of JV company

A Shareholders Deed should explain why the JV company was established and provide background and commercial context about the opportunity that the JV company was established to pursue.

The objectives of the JV company will inform the exclusivity and non-compete obligations of each shareholders. This is important as it will help to determine the level of collaboration among the parties and the extent to which a party may compete with the JV company, or the other parties.

2. Contributions by the parties

The decision for parties to form a joint venture depends on the:

commercial objectives of the parties

level of expertise and capabilities of the parties

It is important to document the nature and extent of each party's contribution in terms of personnel, expertise, physical assets, intangible assets and financial backing.

Sometimes, these details may not be known when the Shareholders Deed is initially signed, especially if the terms of a particular "project contract" that the parties hope to secure are not yet known. In these circumstances, the Shareholders Deed should set out some preliminary terms regarding these contributions, to the extent the parties have visibility on the terms of the "project contract".

3. Indigenous participation

The Shareholders Deed can specify the obligations and targets related to Indigenous training, engagement and capacity building for the parties involved.

This may include provisions such as:

- subcontracting preferences;
- a minimum number of Indigenous contractors or labourers employed or engaged by the JV company;
- awarding a specific value of subcontracts to Indigenous businesses or individuals;
- conducting cultural awareness training;
- providing secondment or training opportunities with a joint venture partner (e.g. an employee of the Indigenous business spending time 'on the ground' working with a JV partner);
- business mentoring opportunities; or
- contributing to the community or other purpose-driven initiatives.

If the JV aims to obtain **Supply Nation Certification**, it is important to address the certification requirements within the Shareholders Deed. For example, the Shareholders Deed will need to include provision to ensure the JV company complies with the Supply Nation certification criteria.

4. Directors – composition, control and voting

It is important to clearly define the division of power and responsibility between the board of directors and shareholders within the JV.

The shareholders of the JV company appoint the directors, and the directors are collectively responsible for the management and executive functions of the company.

Limitations on the powers and duties of the board can be included in a Shareholders Deed to safeguard shareholder interests. For example, shareholders may need to give their approval for the JV company to do certain things (like pursue a new project or issue shares to new participants).

When it comes to the board, the following key issues need to be considered:

- right to appoint and remove directors;
- skills, attributes and experience required to be appointed as a director (for example, a majority of directors may be required to be Indigenous);
- the process for calling board meetings;
- frequency of board meetings;
- how many directors need to be present for board meetings;
- voting rights (whether each director has 1 vote, or if each director's votes are proportionate to their shareholder's ownership);
- addressing voting deadlocks on board decisions; and
- preparing and approving minutes.

As day to day control of the JV company is primarily in the hands of the Board, it is critical that each shareholder has the right to appoint, remove and replace a director. In a 50:50 joint venture, each shareholder should have equal rights to appoint directors and equal voting rights. Training should also be provided to ensure that directors have a good understanding of their legal obligations as directors (including their "director duties").

5. Shareholder meetings

The Shareholders Deed can set out the procedure for calling a shareholders' meeting, which may have similar requirements to those for board meetings.

Particular issues which may be addressed include:

- the number or percentage of shareholders who must agree to call a meeting;
- the number or percentage of shareholders that must be present for a meeting to proceed;
- voting rights; and
- the number of votes needed for particular decisions to be made (i.e. 50%, 75% or 100%).

6. “Special majority” or “unanimous” matters

In cases where a JV company is not evenly divided (50:50) or when one shareholder’s nominated directors have control of the Board, it may be appropriate to require the JV company to get approval from the shareholders to do certain things unless all shareholders approve that decision. These matters are generally the matters that will materially impact the JV company or the shareholders’ interests.

This approval right (which, in practice, is an effective veto) becomes particularly important for a shareholder who does not have control or might lose control in the future.

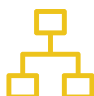
Key matters related to the control or operation of the business may include:

Bidding or entering into specific projects or project contracts

Modifying, transferring, or exercising material rights under a “project contract”

Acquiring or disposing of real property

Commencing or defending legal proceedings



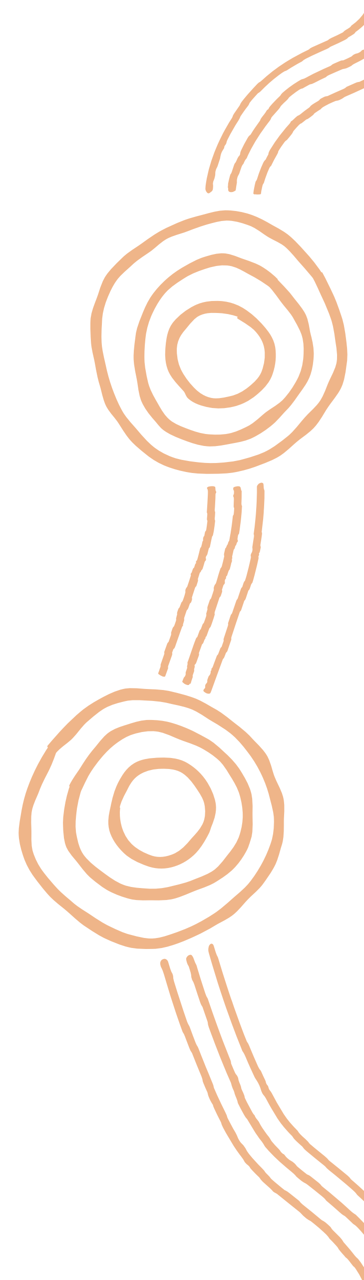
Establishing subsidiaries

Issuing shares or other securities

Providing guarantees and indemnities

Incurring expenditure in excess of the annual budget

Proposing a substantial change or stopping the JV company’s business activities, including winding up related companies.



7. Deadlock

Deadlocks can occur at both director and shareholder level, and it is important to have a clear mechanism to resolve the deadlock.

These terms specify the circumstances where a deadlock is considered to have arisen (e.g. when a proposed resolution fails to pass on more than one occasion) and outline the necessary notice and service requirements, as well as establish a strict timeframe within which the shareholders must act.

Different methods can be used to resolve deadlocks, including:

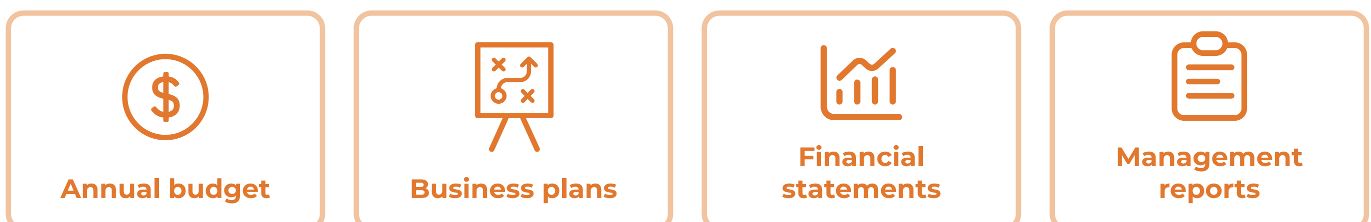
- casting votes, where the chairperson has a second and casting vote;
- arbitration, mediation, or expert determination;
- mandatory transfers of shares;
- "Russian roulette" or limited "Russian roulette" (where one party offers to purchase the other party's interest and the recipient must either accept the offer or buy out the offering party on the same terms); and / or
- independent directors, who possess a second and casting vote to prevent deadlocks.

If independent directors are involved, the parties should consider the necessary qualifications and skills of the independent director, including agreeing on the definition of "independent."

8. Business plans and budgets

A Shareholders Deed should establish procedures for the board's review and adoption of financial reports, business plans, and budgets.

These clauses may require the preparation of the following reports on the activities of the JV company:



A Shareholders Deed may also specify the timeframe for preparing the reports and explain the process for review by shareholders and directors.

The activities of the board and JV company are generally limited to the scope outlined in an approved budget or business plan, giving shareholders confidence that the directors can only operate within the boundaries of an approved business plan.

9. Management Agreements

The business activities of a JV company are generally managed by one party to the JV under a separate agreement.

A Shareholders Deed should set out the key features of the management arrangements, such as requiring the terms of the management agreement to be fair and transparent, outlining what reporting is required, identifying the details that must be included in invoices and setting out how or when invoices will be payable (e.g. only once the JV company begins generating a profit). Please see "Understanding the Management Agreement".

10. Funding and security

Shareholders Deeds often include provisions regarding the initial financial contributions that the shareholders are required to make to the JV company for its start-up funding.

Shareholders may also agree to contribute additional funds to support the JV Company in certain circumstances, and this can be addressed in the agreement.

Some options for addressing circumstances where the shareholders may be required to provide additional funding include:

1. No commitment to provide further finance
2. Commitment to provide further finance up to a specific amount
3. Commitment to provide further finance that it is proportionate to the shareholders' ownership percentages or other contributions
4. Unlimited commitment to ensure the company remains solvent
5. Undertakings to guarantee or not guarantee finance received from a third party

These options allow parties to agree their obligations and expectations regarding future financial support for the company.

In many Indigenous joint ventures, one party may lend funds to the JV company to help fund the initial working capital requirements. In these cases, the terms of repayment should be agreed and set out in a separate loan agreement that is acknowledged in the shareholders deed. A loan agreement should be on clear and transparent terms and not impact on the JV company's ability to declare, or pay, dividends. Ideally, the loan agreement will also provide that interest is not payable in respect of any initial working capital for a certain period of time. The loan agreement should provide a generous period of time for repayment (so that the Company can build the funds required to address the cash flow impact of repayments of principal and/or interest.

11. Share transactions and pre-emptive rights

Shareholders Deeds also address the circumstances where a shareholder can sell their shares, and the rights of other shareholders where there is a proposed sale of shares.

With some exceptions (such as transfers between related parties), the sale of shares is generally prohibited unless a process that provides other shareholders with a "right of first refusal" is followed. The process should be clearly set out in the Shareholders Deed, including what mechanism will be used to value the shares (e.g. accounting method or third party valuer).

Alternatively, some JV companies prohibit the transfer of shares without the consent of all shareholders.

JV parties carefully choose who they would like to work with in a JV company and, as a result, there must be some restrictions on who can become a shareholder in the company.

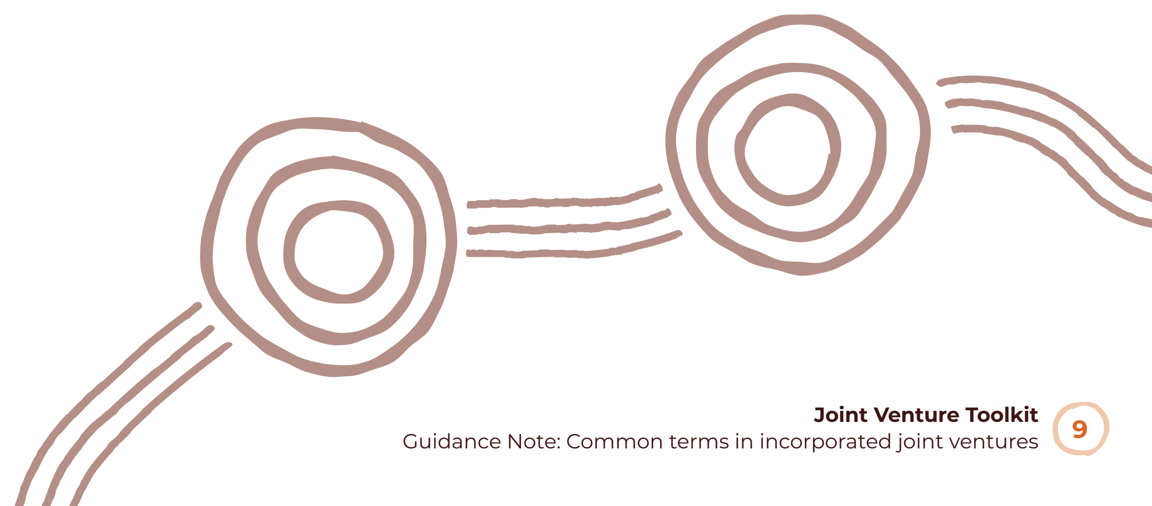
12. Change of control

A "change in control" refers to a situation where there is a significant change in the ownership or control of a shareholder (e.g. change in ownership of 50% or more of the shares).

A "change in control" clause in a Shareholders Deed will place limits on any changes in the ownership of a shareholder.

A "change in control" clause may provide that, when there is a significant change in the ownership or control of a shareholder, the other party to the agreement has the right to buy the shares of the shareholder who experienced the change in control, in accordance with a process and valuation mechanism that is set out in the Shareholders Deed.

Similar to restrictions on share transfers in the JV company, this prohibition aims to provide the parties with certainty regarding their JV partners.



13. Involuntary transfers and default

A buy out right or involuntary transfer is a common remedy for a serious default by one shareholder. It allows the other shareholders to require the defaulting shareholder to transfer their shares to the other parties to effectively protect the JV company.

The clause specifying involuntary transfers outlines the situations in which such transfers can occur.

These situations typically include when a shareholder:

- is in default of an important provision of the Shareholders Deed;
- has an encumbrance placed over their shares without the consent of the other shareholder;
- becomes insolvent;
- has a court judgment enforced against them for a specified amount; or
- experiences a change of control without consent.

It is critical that a Shareholders Deed does not require shares that are transferred in these circumstances are sold at a lower price than would otherwise be the case.

However, in the context of a JV company, a buyout right may not be an effective solution as its likely that one shareholder cannot undertake the JV company's business alone - the parties came together to undertake the business jointly, so forcing a buyout may not be a practical or commercial remedy.

14. Consequences of default

The default provisions in a Shareholders Deed need to outline different consequences that may be imposed where a shareholder breaches their obligations or is in default under the Deed.

These may include:

Suspending the rights of the nominee directors appointed by the defaulting shareholder

Suspending the right to receive dividends or other distributions from the JV company

Allowing other shareholders to buy out the defaulting shareholder

15. Dividends and distributions

A Shareholders Deed must clearly identify who is responsible for deciding how and when the profits of the JV company should be distributed.

Some options include:

- giving the board of directors the authority to declare and distribute dividends - the board will decide whether dividends should be paid and the amount of the dividends
- a distribution policy agreed between the shareholders that has a predefined order of priority as to the order and amount of dividends (i.e. the shareholder that contributes the most funds receive the greatest portion of the JV company's profits, often referred to as a "waterfall" policy).

These provisions should be carefully reviewed to ensure that they don't unfairly or unnecessarily prevent a party from accessing the JV company's profits.

16. Valuation of shares

Determining the value of shares in a JV company, especially during disputes or buyout situations, can be challenging. It is important to establish a clear procedure to address this issue in the Shareholders Deed.

Some factors to consider include:

- accounting for minority discounts, which may reduce the value of shares held by minority shareholders;
- identifying appropriate valuation methods to determine the value of the shares;
- deciding whether to agree on a valuer internally or seek an external appointment to conduct the valuation; and
- ensuring the rights of shareholders to provide their input and submissions during the valuation process.