Joint Ventures

IISD Best Practices Bulletin #1

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In this best practices series on legal tools for responsible investment in agriculture, IISD analyzes key legal and policy issues arising from the legal instruments that states use to govern responsible investment in agriculture and food systems. These bulletins are designed to help government policy-makers and agricultural investment negotiators understand the benefits, limitations, legal risks, and policy issues raised by different legal tools for investment in agriculture.

IISD hopes that they will support agricultural investment negotiators, state lawyers, and policy-makers in deciding whether and how to use certain legal tools to help achieve their country's sustainable development objectives for investment in agriculture and food systems. By doing so, IISD aims to level the playing field in agricultural investment negotiations and ensure access to the latest thinking and approaches.

The guidance in this bulletin does not replace specific legal and financial advice from local experts, a close understanding of the domestic law, or the development of a rigorous business case for why a legal tool is appropriate for a given agricultural investment project.

1.0 Introduction

As governments increasingly look to different models for attracting and delivering private investment in agriculture, one approach that is gaining interest is the public–private incorporated joint venture. In this model, "a public sector body and the private sector contribute to a commercial venture and agree to develop and manage that business on a joint basis"(HM Treasury, 2010). This model is not as currently common in agriculture (FAO, 2016)[1] as it is in other sectors such as water (Castro & Janssens, 2011) and infrastructure (United Nations Economic and Social Commission for Asia and the Pacific, 2008). However, its use is likely to increase along with the growing focus on public–private partnerships (PPPs) for agribusiness investment.[2]

Where joint venture models are used in agriculture, investment in production technology or trade infrastructure is often a key feature. For example, joint ventures have been used in the Philippines for the development of an agricultural trade terminal (Rankin et al., 2016), in Rwanda for irrigation and fertigation technology (Ntirenganya, 2019), in Malawi for greenhouses ("Malawi to start," 2020), and in South Africa for a research and training feed mill and laboratory ("Joint venture to launch," 2020).

[1] In a study of 70 agribusiness public-private partnerships, the Food and Agriculture Organization of the United Nations (FAO) found that the JV model was only used in "exceptional" cases.

[2] For example, the Food and Agriculture Organization of the United Nations (FAO) and the African Union Commission (AUC) have developed guidelines for the design and implementation of effective public-private partnerships in the agriculture sector. The AUC encourages its member states to promote PPPs through their national agricultural investment plans. See African Union (2019).

2.0 What Is a Public–Private Joint Venture?

Public–private incorporated joint ventures represent a unique project structure that carries unique benefits and risks in the context of agriculture, particularly for developing country governments.

This model is a **public–private joint venture** because it involves a collaboration between a public entity and an investor that is a private company,[3] as distinct from a joint venture between two private companies. It is an **incorporated joint venture**, because it is carried out through a dedicated company that is established by the public and private partner to set up and run the project (the "joint venture company") (International Institute for the Unification of Private Law [UNIDROIT], 2013). In this arrangement, the public and private partners each contribute equity, share profits, and jointly manage the company. A key feature of this joint management is that both partners appoint board members to the board of the joint venture company. An **incorporated joint venture** is distinct from a **contractual joint venture**, in which no new company is created (UNIDROIT, 2013).

Public–private incorporated joint ventures (hereafter referred to as "JVs" for brevity) represent a unique project structure that carries unique benefits and risks in the context of agriculture, particularly for developing country governments. The purpose of this bulletin is to highlight some of the key risks associated with JVs, and to provide some guidance to agricultural investment negotiators and government lawyers as to how they can be mitigated through careful legal drafting.[4]

[3] A private partner might be a foreign state-owned entity, but for the purpose of this brief such entities are treated as "private" as they will be behaving commercially in any case.

[4] This bulletin does not address the question of when a JV structure will be appropriate for a given agricultural investment project, which will need to be answered with a clear business case supported by detailed planning. Nor does it address the issue of competitively selecting a JV partner, which is a matter that is usually regulated by the domestic law on procurement or public-private partnerships.

3.0 Potential Benefits of JVs From a Government Perspective

Governments often pursue JVs in all sectors because they are seen as (World Bank Group Public Private Partnership Legal Resource Centre, 2016):

1. Combining the strengths of the private sector—such as innovation, financial capacity, commercial, managerial and operational expertise, and access to technology—with those of the public partner, such as pursuing public interest objectives, creating an enabling policy environment, and knowledge of the local and national context (Castro & Janssens, 2011).
2. Creating an opportunity for a transfer of skills from the private partner to the public partner.
3. Giving access to sources of market finance that a government's credit rating may not allow.
4. Allowing the public partner to exercise control and oversight over day-to-day investment activities, or at least key decisions (at the board and shareholder level) of the JV company.
5. Providing greater transparency of the financial performance of the agribusiness project.
6. Allowing for the public partner to share in the profits of the JV company.

In addition to the above, in the context of developing countries, there can be a perception that agricultural JVs are:

1. More publicly acceptable and politically feasible, given concerns and previous negative experiences with other investment arrangements involving agricultural land, such as leases, concession agreements, and management contracts.
2. More attractive to a foreign investor who sees the structure as better for sharing risk in a potentially unfamiliar developing country context that may be seen as high risk.
3. Preferred by local interests, as JVs are seen as a model that keeps land in public hands (compared to a long-term lease, for example).

4.0 Risks of JVs From a Government Perspective

It is important to note that there is no guarantee that this JV model will deliver the above benefits, and there are several risks associated with this model.

4.1 Conflict of Interest

The JV model involves what the World Bank Group describes as an "in-built conflict of interest" (World Bank Group Public Private Partnership Legal Resource Centre, 2016). At the heart of this conflict is the fact that the state and the private company each have fundamentally different objectives—the state aims to maximize public welfare, and the company seeks to maximize profit (James & Vaaler, 2013). In the context of a JV, this conflict can manifest in different ways. One such conflict is whether the public partner is to behave like a business partner or a government regulator. A similar point of conflict arises where the JV company provides goods or services to the public sector. Take, for example, a JV to produce fortified food products for publicly funded school meal programs. This makes the public partner in the JV both the business co-owner and a client at the same time.

It can be challenging for governments to negotiate and then enforce a joint venture agreement, particularly under pressure from the private partner to conclude a deal, often on the basis of a draft contract prepared by the private partner.

4.2 A Lack of Real Control and Oversight

Another risk of the JV model is that the public partner's representation on the board of the JV company may not result in real control and oversight of the JV company (World Bank Group, 2016). This can happen for different reasons. One is that the public partner may lack the capacity to effectively participate in the management of the JV company. Government-appointed board members may not have the time or expertise to engage with the issues discussed at board meetings, or they may not receive enough information with enough time to properly evaluate it (Wells, 2014). Government-appointed board members could also be cut out of the decision-making process. The private partner can choose to make key decisions before board meetings rather than putting them on the agenda to discuss at the board level (World Bank Group Public Private Partnership Legal Resource Centre, 2016).

4.3 Dividends Don't Materialize

A further risk is that the JV company may fail to pay out the promised dividends, which may have been a compelling reason for the government to choose this model (World Bank Group, 2016). This is because dividends are typically paid out of profits, and there are several ways for the JV company to artificially reduce profits to avoid paying dividends. The

JV company can do this, for example, through self-dealing,[5] lending excess cash to affiliates elsewhere, paying large salaries to executive staff, or making large payments as fees to sub-contractors that they control.

4.4 Investors Avoid Arm's Length Regulation

In some instances, the private partner prefer a JV model not based on a strong business case that it might be the best way to run the agribusiness project, but rather as an "insurance policy" to manage its relationship with the government. For example, the private partner may prefer a JV (with a minority shareholding for the government) so the JV company can evade external scrutiny that would be directed toward a fully private company. In this context, the private partner may try to argue that the votes of government-appointed directors constitute government approval even where that director does not represent the relevant ministry or regulatory authority (Wells, 2014). Investors may also seek a JV with minority shareholding for the government to lower the risk of legitimate regulatory change or contract renegotiations impacting the project (James & Vaaler, 2013).

Box 1. A note on unsolicited proposals

With all forms of PPP, under-resourced governments can be approached by private investors with a proposed project which they are then left to consider with insufficient information, i.e., without an evaluation of the project approach in comparison to other models. Government officials can feel pressured or politically coerced into concluding an agreement on that specific project. However, ideally, a government will plan its investment activities in advance and identifying preferred structures for delivering those investments—which may be a JV or another form of PPP or other structure. The government may get best value for public money by using a competitive procurement approach based on the goals and priorities it has outlined rather than pursuing a negotiation with an investor making an unsolicited proposal for a JV or other type of project. Some governments have developed detailed frameworks for handling and evaluating unsolicited proposals, to try and promote value for money and transparency in procurement, while still acknowledging a private investor's initiative in making the proposal.

Source: World Bank, 2020.

Some of these risks can be mitigated through a carefully drafted and implemented JV agreement. It can be challenging for governments to negotiate and then enforce such an agreement, particularly under pressure from the private partner to conclude a deal, often on the basis of a draft contract prepared by the private partner. Below are some considerations to help governments conclude better JV agreements for agribusiness projects.

[5] This is when two related companies trade with each other, and artificially distort the price at which the trade is recorded. This has the effect of inflating costs and reducing profits. This can happen in particular where control of pricing information resides with the private parent. Self-dealing pricing often occurs through the provision of technical services, which can be "invisible."

5.0 Choosing to Use a JV Structure

Ultimately, a government considering using a JV should carefully think through whether this is the right structure for a given agribusiness project. Here, some key questions to consider are (HM Treasury, 2010):

1. What are the benefits that the public partner wants to get out of this project?
2. What are the risks that may prevent these benefits from being realized?
3. Does a jointly owned and managed business offer the best structure for the management and mitigation of these risks and realization of these benefits?
4. What can a joint venture do better than the government alone, or the investor under a more "arm's-length" contractual arrangement in which the public sector transfers risk to the private sector (like a concession agreement)?

6.0 Key Questions to Be Answered Before Drafting a JV Agreement

The fundamental question for a government is whether a JV is the right model for a given agribusiness project. If the answer to that is "yes," the next step will be to draft a JV agreement. This section sets out some of the key issues that a JV agreement between the public partner and the private partner should cover off. Thinking through these issues carefully before arriving at the negotiating table can help mitigate the risks with the JV model outlined in the previous section. This is not a complete list of all the issues that need to be carefully considered in developing a JV agreement, but a selection of some of the key issues to take into account.

Box 2. A note on JV Agreements and other legal documents

The name of the document setting out the terms of a JV agreement will usually depend on the exact corporate structure the JV is taking. If it is a company, this is usually called a shareholder's agreement, but for other corporate structures it could have a different name. What corporate structures are available will usually depend on the companies law of the country. For the purposes of this best practices bulletin, we will refer to this document as a "JV Agreement." The JV arrangement may also require additional legal documents, such as:

1. A lease agreement for any land being put under production.
2. Agreements seconding staff from the public partner to the JV company.
3. Articles of association for the JV company.

The list of documents needed will depend on the project and on the domestic legal requirements, in particular the companies law.

6.1 How Will the JV Be Funded?

6.1.1 Initial Funding

The issue of initial equity contribution is a critical one, because it will impact both the public partner's level of financial exposure, and its level of control over the company (HM Treasury, 2010 p. 57). In some contexts, the public partner may not wish to be a majority shareholder in the JV company, due to the financial risk and burden on management this may entail. In other situations, the public sector may prefer to retain a majority share in the ownership of the JV to ensure that the company maintains its focus on creating public value (Castro & Janssens 2011).

The extent of the public partner's shareholding in an agribusiness JV may depend on the nature of the project and the extent to which it is intended to deliver public goods. The

While land and infrastructure are perhaps the public partner's most tangible contribution to the partnership, it is important to clearly spell out what else the public partner is bringing to the venture.

public partner may consider that retaining a majority share is particularly important in the case of a JV company that is producing a staple crop for domestic consumption or a fortified food product to address problems of local malnutrition, for example. Having a majority shareholding may perhaps be less important to the public partner in the case of a JV project producing a cash crop for export, for example.

In an agribusiness JV, the public partner's initial contributions will usually be in the form of land and may also include other forms of infrastructure such as roads and irrigation. As such, it will be important to determine how these assets will be valued and who will pay for valuation.[6] It may be necessary to seek multiple valuations to ensure that the public partner's contribution is valued accurately.

While land and infrastructure are perhaps the public partner's most tangible contribution to the partnership, it is important to clearly spell out what else the public partner is bringing to the venture. For example, the importance of the public partner's local knowledge, relationships, and convening power should not be underestimated and therefore undervalued.

6.1.2 Ongoing Funding

In addition to the initial equity contributions of both partners, it is vital to consider and set out in the JV agreement how the JV company will be funded on an ongoing basis, both from the parties and external sources. It is important to agree and set out whether the parties will be required to contribute further capital to the JV company (World Bank Group, 2016) and, if so, when and under what circumstances. Government should avoid language in JV agreements that commits them to make additional cash contributions "as and where necessary." These types of unlimited commitments to contribute further capital are risky for the public partner to make, particular in the context of low-income governments with limited resources to contribute on an ongoing basis. Initially, much of the funding is likely to come from external sources (loans) and later, retained profits will become more important.

6.1.3 Dividend Policy

The dividend policy could include issues like specifying a minimum amount of profits to be retained each year for reinvestment and giving the public partner a veto power over the issuance of dividends above a certain amount. Is the intention to provide ongoing economic returns to the parties from the outset of the JV? Should there be a period where no dividends are distributed, and any initial profits made would be used to further the development of

[6] The National Economic and Development Authority of the Philippines' Revised Guidelines and Procedures for Entering into JV Agreements between Government and Private Entities (the NEDA Guidelines) require that the government's contribution in the form of assets shall be subject to a third-party independent valuation. p. 3, paragraph 6.2.b.

the project? A dividend policy could also prevent the JV company from issuing dividends until all loans made by the parties to the JV company have been repaid in full (Practical Law Corporate, 2020). This type of restriction may be necessary if the public partner makes significant loans to the JV company—if not, it may not be relevant, and in any event should be drafted carefully so as not to be overly restrictive (HM Treasury, 2010).

6.1.4 Providing Loan Guarantees or Collateral

It is important to clarify the public partner's position on providing guarantees or collateral to support finance raised by the JV company (World Bank Group, 2016). Contractual language containing broad commitments to "provide such guarantees as may be required," for instance, can be very risky for the public partner. The risk is further increased if the investor in question is not bringing significant expertise and technical ability to the project.[7] In addition, the public financial management laws of some countries do not allow for the giving of government guarantees without following a clear procedure, for instance obtaining approval of the cabinet of the minister in charge of finance.

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6.1.5 Land

Land is one of the most important and contentious issues at the heart of any agricultural investment project, including one that uses a JV structure.

It is critical that the JV agreement clearly sets out how the land is to be dealt with over the lifetime of the project. For instance, what will be the consequence of the JV company failing to develop the land as promised? Under what circumstances can the public partner take the land back? Will the JV company forfeit its performance bond if it has paid one? It is also critical for the public partner to consider and reflect in the JV agreement (as well as any lease agreement) what is to happen to the land when the JV comes to an end (World Bank Group, 2016).

More broadly and importantly, the rights of legitimate tenure rights holders over land used for a JV project should be governed in accordance with international best practice principles such as the FAO's Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security (FAO, 2012).

[7] The NEDA Guidelines are quite detailed on the financial contribution of both parties to a JV, and require that all JV agreements contain a provision for:
The establishment of a fund by the parties to finance the work, together with the amount, type (cash, assets, etc.), and valuation of committed contributions of each party and when such contributions will be made, with the fund being deposited in a special bank account under dual control and all progress payments and other revenues being deposited in such account. if the equity/contribution of the private sector is to be borrowed, a statement that there shall be no government guarantee for said loan;
And a provision setting out a:
Procedure for additional capital infusions, if required, and a statement that there shall be no government guarantee for loans to be incurred by the private sector in case the additional contribution of the private sector is to be borrowed. NEDA Guidelines, p. 8 1, para (i).

Box 3. A note on investment contracts with JV companies

In some situations, particularly where the private partner is a foreign investor, it may also push for an investment contract between the JV company and a government entity—with the public partner as a representative of the wider government, or another public authority such as the ministry of agriculture or investment board. The private partner may want an investment contract to contain commitments from the government to provide, for example, investment incentives such as preferable corporate tax rates or tax holidays. They may also seek contractual commitments for some forms of facilitation to "smooth the path" for the JV company, such as assistance with obtaining operational permits and licences, or provision of "unencumbered" land.

The JV agreement should not contain investment contract-type commitments in it—for example, facilitation of land, access to infrastructure, tax incentives and assistance obtaining permits and visas for personnel. Putting these in the JV agreement places the public partner in the conflicted position of granting incentives on behalf of the government and benefitting from those incentives as a partner delivering a commercial project. These types of commitments would usually require the approval of a broad range of government ministries and agencies, including the tax, customs, and immigration authorities, utilities regulator, and ministry responsible for water and land. If it is seen as necessary for these types of incentives to be granted to the JV company, this should be done through a separate contract between the JV company and a duly authorized representative of the government.

Source: Smaller et al., 2014.

6.2 What Level of Control and Public Oversight Does the Public Partner Want?

The number of directors that the public partner can appoint to the board is critical to the degree of oversight and control it will have over the JV company's business. A JV agreement in which the private partner appoints the majority of directors and the chair with a casting vote will not give the public partner any real power to influence the major decisions affecting the JV company. This means that the JV company could potentially accrue big debts, issue new shares that would dilute the public partner's shareholding (and potentially its voting and appointment rights), or change its business model, even if all the public partner-appointed directors voted against it.

In negotiating a JV agreement, the public partner should carefully consider what split in terms of board appointments is fair, appropriate, and allows the public partner to exercise enough control over the JV company while still ensuring that the JV company can be managed efficiently (HM Treasury, 2010). The public partner should ensure it appoints well-qualified directors and requires them to report periodically, and to flag any potential issues early. The number of board appointments should reflect the equity contributions that the public partner is making to the JV and the amount of control and oversight the public partner wants to have. The power to appoint the chair is also important.

Where the public partner takes a minority shareholding, corporate governance elements will be especially important to protect the public partner's rights of control and oversight. Below are three important elements to consider in this respect:

The JV agreement can set out when, how often, where, and how board meetings are to be conducted and board decisions are to be made.

6.2.1 Board Decision-Making Procedure

Details of board decision making are important as they can prevent the majority shareholder from abusing the rights of the minority shareholder. This could happen, for example, by the majority shareholder calling a meeting without notice when they know the minority shareholder's appointed directors are unavailable and making key decisions in their absence. The JV agreement can set out when, how often, where, and how board meetings are to be conducted and board decisions are to be made. These provisions should all be consistent with—and refer where appropriate to—the relevant provisions of the domestic companies law. This includes:

1. Quorum—for example requiring at least one minority shareholder-appointed director be present to constitute a quorum.
2. The notice required to call a meeting, so there cannot be last-minute surprise meetings.
3. The procedure for agenda setting, and what issues are standing agenda items, so that the majority shareholder cannot control agenda setting to avoid discussion of key issues.
4. How voting is carried out.
5. What is the process for resolving a situation (a "deadlock procedure") to be used if the board cannot reach a decision on an issue.
6. How the chair is appointed and what happens if the chair is unavailable.
7. Who will appoint the executive management team and what their duties will be.
8. What authority is to be given to individual managers (e.g., the CEO) and what matters must be dealt with at the board level.

6.2.2 Setting out a List of "Reserved Matters"

It may be important to identify certain decisions that can be made with the permission of both the public partner and the private partner, and to give the public partner a right of "veto" over very key decisions. This means that the parties agree ahead of time on a list of matters that are to be kept for the shareholders themselves to make, as opposed to decisions taken by the

board.[8] Examples of reserved matters could include incurring debts above a certain amount, issuing new shares, distributing dividends, entering new lines of business, entering into or terminating major contracts, disposing of company assets above a certain value, executive pay, and mergers or acquisitions (Practical Law Corporate, 2020).

6.2.3 Issuing New Shares

The JV agreement should set out whether the JV company's directors can issue new shares, for example to raise more funding through equity. The public partner may want the right of veto for any issuance of new shares that would dilute its voting and appointment rights. The JV agreement may also need to ensure that a new shareholder is subject to the same undertakings as the original parties, and that the JV agreement can be reviewed if needed upon the issuance of new shares.[9]

6.3 What Is the Public Partner's Exit Strategy?

Thinking through the end of the JV agreement is just as important as deciding how the JV will be set up and run. There are several ways the JV agreement might come to an end; through termination as a result of a breach, expiry of the term, or because one party wishes to sell their shares and leave the JV. These three situations are very different and so may require different consequences. And as both parties are shareholders of the JV company, they cannot easily "walk away" from the agreement; there must be some plan for how the shares of one party will be transferred to the other or to another party.

The public partner should carefully consider whether it wants to remain in the JV for the full term of the agreement. A different strategy is to remain in the partnership for a shorter period to help get it up and running, and then transfer its shares to the private partner or another investor, ending the JV but allowing the business to continue. The public partner may also simply wish to keep an exit strategy for if its financial position or priorities change in future – again, careful drafting will be needed to ensure a clear and effective exit strategy.[10]

Just three of the key elements to consider for inclusion in the JV agreement include:

1. How can a party sell its interest and exit the JV? For example, if the term of the contract has expired, or one party wishes to divest and leave the JV, they could be

[8] Permission on reserved matters can be required to be given by both shareholders (if there are only two), or a by majority of shareholders' voting rights (if there are many shareholders), and this permission can be required in writing.

[9] Additional shares could also be issued to the private partner in return for additional funds from the parent company. When this happens, if the value of the JV's fixed assets have increased, the value of the public partner's share of those assets (usually land) can be used to boost its share stock. This way, the public partner's share need not be diluted too much. This reinforces the importance of an accurate valuation of the public partner's equity contribution to the JV project.

[10] In this respect, the NEDA Guidelines provide that a JV agreement must stipulate a fixed term for the government entity's participation in the JV which does not exceed 50 years, but divestiture (through transparent and competitive means) of the government's equity contribution before the expiration of that period is encouraged. p. 3, para (e).

required to first offer their shares at market value to the other party, and if that party chooses not to buy, then they can seek a third-party buyer. Other issues to consider include what happens to any assets, loans, or guarantees contributed by the exiting party, and what will be the process to approve a new incoming participant (Practical Law Corporate, 2020).

2. What breaches would be serious enough to allow the parties to terminate the JV agreement? Usually an agreement of a complex and long-term nature will set out which types of breach are considered "material," and therefore can trigger the termination of the agreement. These are usually breaches that are very serious and fundamental, like fraud, serious misrepresentation, change of control, or insolvency of the private partner (World Bank Group, 2016).
3. What are the consequences of termination? The public partner may want the right to trigger the winding up of the JV company or to require that the private partner transfer its shares to the public partner at a discounted penalty rate. This is because the public partner, especially if it is a minority shareholder, may not be able to afford to buy the private partner's shares at full price, and so may not be able to enforce a breach if these termination provisions have not been carefully thought through (HM Treasury, 2010).

7.0 Conclusion

This best practices bulletin has given a brief overview of a selection of important issues that developing country agricultural investment negotiators, state lawyers, and policy-makers may wish to take into account when using JVs as a model to deliver responsible investment in agriculture. As previously noted, this guidance does not replace the need for local legal and financial advice specific to a given agribusiness project.

Box 4. A note on template contracts

If the JV model is one that a government authority is likely to use often, it may be useful to consider developing a JV template agreement. Templates can be a useful way to develop a comprehensive and well-adapted JV agreement outside of the pressure of a live negotiation, which can be carefully reviewed and vetted by all government stakeholders ahead of time. A template JV agreement can have "red line" provisions that must be included and other provisions that may be more flexible on a project-by-project basis. A template also allows the government to be the one to put a first draft of the contract on the table, which provides an important strategic advantage in negotiations. Templates can be published on a government website. This can support the government in its negotiating positions by reassuring the investor that the government values transparency and consistency in its contractual negotiations and is not singling out an investor for any particular treatment.

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