Joint venture agreements: part 9 – family meetings and decision-making

The model JVA sets forth a fairly traditional framework for shareholder governance. Article 8 addresses the following topics: shareholders as JVCo’s ‘ultimate authority’ (art 8.1), matters reserved for shareholder decisions (art 8.2), meetings (art 8.3), meeting notices (art 8.4), waivers of notice (art 8.5), president and secretary of meetings (art 8.6), voting by proxy (art 8.7), quorum requirements (art 8.8), one vote per share (art 8.9), matters requiring unanimous or supermajority vote (art 8.10), matters requiring simple majority or lower threshold supermajority vote (art 8.11), tie breakers (art 8.12), efforts to reach consensus (art 8.13), meeting minutes (art 8.14) and written consent in lieu of meeting (art 8.15).

This is a fair dispute resolution process to ensure that all owners have the real possibility of having their business ideas and circumstances taken into account. In addition, this phase of the JVCo’s existence, most actions are likely to be taken by the shareholders of the joint venture company (‘JVCo’), either in a meeting or by written consent.

At all times, governance of the JVCo can be considered at three levels.

“In a typical project development and finance transaction, the formalities and infrequency of shareholder meetings and voting contemplated by art 8 are unrealistic. Article 8, for example, contemplates an annual ordinary meeting and extraordinary meetings that can be called from time to time by the board, shareholders holding a specified value (or percentage) of equity (option 1) or the auditors (option 2). During the start-up stages of a project, the JV parties are likely to be in constant communication and the need for rapid decisions on critical issues may occur with much greater frequency than envisioned in art 8. As discussed in part 2 of this series, whether such decisions are nominally taken by the board (which will typically include proportional representation of all JV parties) or by the shareholders (which will be the JV parties acting in their capacity as such), the decision-making process effectively comprises shareholder meetings and voting on a weekly basis. In addition, during this phase of the JVCo’s existence, most actions are likely to be taken by Quaker consensus, meaning that they are based on consensus building and strive for unanimity.

At all times, governance of the JVCo can be considered at three levels. First, the JVCo’s board of directors, who will be chosen by its shareholders, will manage the JVCo’s business and affairs, also in accordance with its statutes and the law of the jurisdiction of its incorporation. Assuming all JVCo shareholders are also JV parties, which is usually the case initially in a closely held project development and finance JV, then all matters stipulated by the JV parties in the JVA, or to be decided by the JV parties as set forth in the JVA, are essentially shareholder governance actions. Under art 28 of the JVA, those rules may only be changed in writing signed by all the JV parties, ie by unanimous consent. Article 8 thus introduces the second level of JVCo governance. However, as set out in the JVA, it is important to remember that this provision is only binding on the JV parties and not on other shareholders of the JVCo unless it is repeated in the JVCo’s statutes.

Typically, representation on the JVCo’s board will be allocated proportionately among the JV parties according to their percentage interests. The model JVA addresses the process of allocating board seats among the JV parties in art 9, which will be discussed in the next instalment. Where there are only a few JV parties, and each has a large enough percentage to merit at least one board seat, the board affords all JV parties with proportional representation, and virtually every action can be taken by the board without need for a more formal shareholder meeting. (Or, viewed differently, every board meeting is effectively a shareholder meeting, except that rather
than having one voter per shareholder with the number of votes based on the number of shares, there is one voter for each defined increment of shares, with each voter having one vote in the boardroom.) Part 2 of this series noted that board members in such cases may actually be better designated as shareholder representatives to clarify that they can vote directly in the interests of the JV parties they represent without having general fiduciary duties, such as the duty of loyalty or fidelity, to the JVCo or the other JV parties.

The lawyers for the JV parties may thus wish to consider including the more traditional shareholder governance procedures in the JVCo’s statutes, but to replace JVA art 8 with a procedure that more accurately and directly reflects the actual governance and decision-making process that the JV parties will follow. Many of the concepts in art 8 will still need to be addressed. In particular, the JV parties will need to itemise those actions that require unanimous approval, those that require supermajority approval and those that will be left to a simple majority. The items included in each list will depend on what is considered more or less fundamental given the JVCo’s business and operating constraints, the number of JV parties and percentages of equity held by each, and other relevant factors, such as whether there is a management contract between the JVCo and a JV party whereby the JVCo outsources certain responsibilities and authority to that JV party.

Notwithstanding these considerations, the lawyers negotiating the JVA also need to be prepared to address the possibility that the JVCo may have one or more shareholders from the outset who hold a relatively small percentage of shares and may not have representation on the board. These could include, for example, vendors who take full or partial payment in shares rather than cash. While some protection for the interests of these minority shareholders will need to be included, they should be considered the tail rather than the dog and should not form the basis for abandoning a more efficient and pragmatic governance structure.

In addition, the lawyers for the JV parties should be cognisant that the JVA contains numerous pre-agreed terms and conditions for the JVCo and also sets out numerous matters to be agreed by the JV parties from time to time. Great care must be taken to harmonise the decision-making process set out in art 8 with the operation of these other provisions. Failure to do so will cause problems and disagreement down the road. In particular, the drafters must avoid any conflict between the requisite non-unanimous approval by shareholder action under art 8 versus the unanimity required to amend the JVA under art 28. The equally emphatic statements of art 8.1 that the meeting of shareholders is the ‘ultimate authority’ of the JVCo, and art 28 that the JVA may only be amended by written approval of all the JV parties, if in conflict, do not provide any hierarchy for which overrides the other. The author has seen numerous disputes arise or escalate over the years out of such drafting ambiguity.

The lawyers for the JV parties should also consider modifying the unanimous consent provision in art 8.15 to allow decisions to be taken by the written consent of the holders of a sufficient number of shares so that they would have been able to approve the action at a meeting of shareholders at which every shareholder was present and voted. This opens up written consents to a greater range of situations, streamlining the governance process, and is now permitted by the company and corporate laws of a growing number of jurisdictions.

As a start-up venture undertaking a major infrastructure project, the JVCo will require the continued support and consensus of all JV parties to succeed. Thus, notwithstanding the governance provisions set out in the JVA, if any JV party becomes consistently discontent with the direction of the JVCo and the actions of the other JV parties, or the remaining JV parties become consistently discontent with a JV party’s performance of its role in achieving the objectives for the JVCo’s business, the situation becomes untenable. In the author’s experience, it is not uncommon for some JV parties to exit and be replaced in the early stages of a JV. Whether through the formal exit and buy-out mechanisms set out in the JVA (which will be discussed in future instalments) or through a negotiated transaction, the minority that is discontented, or causing discontent to the majority, will typically face an early exit from the JV. In many ways, these solutions are the answer to what must otherwise be a consensus-based approach to all major corporate and business decisions of the JVCo in order for it to achieve the goals of the JV parties.

In conclusion, the traditional shareholder governance process set out in art 8, while perhaps appropriate for the JVCo’s statutes, is too formalistic, cumbersome and slow for the fast-paced start-up stage of a project JVCo. Even in the more mature stage of the JVCo’s business, while art 8 as set out in the model JVA imposes a theoretically reasonable governance process, it is nevertheless one that is unlikely to be followed and hence of little practical use to the JV parties. The author has seen many such provisions in a wide variety of JVA’s, not just those based on the model JVA, and they provide too little help too late in resolving time-sensitive governance issues. Lawyers for the JV parties are thus encouraged to re-write art 8 to reflect the actual governance process to be adopted by their clients. They and their clients must also anticipate that any major decisions impacting a project JVCo taken by less than unanimity are likely to lead to an early exit by the dissenters, either because they want out or because the majority wants them out. It will thus be important to ensure that the exit provisions tie in to disagreements over governance, a topic to be taken up later in this series.

Part 10 of this series will appear in the February edition.