

# Joint ventures: A forest investment alternative

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There are a number of different ways in which ownership and operation of a forest can be structured. The most obvious form of ownership is where a party owns the forest land outright.

However, increasingly people are purchasing forests as co-owners. The rationale behind this is that the participating parties can combine their efforts, resources and skills in order to achieve a better commercial result than if they acted independently.

Where parties are considering purchasing land as co-owners it is paramount that the arrangement is clearly understood by the parties and formally documented at the outset so as to help avoid disputes and disaster later on.

## Meaning of joint venture

Often when parties are looking at co-ownership, they refer to the arrangement as a joint venture. The term "joint venture" is vague and in fact can cover a number of different legal structures. As discussed below, it is necessary to look carefully at the structure that is intended and plan accordingly.

## Business rationale

Joint ventures have become widely used by companies to gain the various competitive and strategic benefits. The structure allows capital to come from more than one source. As important, it often leads to the participants contributing different skills to the venture – one may contribute capital and the other may contribute management skills. Also, it may allow investors and particularly international investors to acquire local knowledge and contacts by entering a joint venture with a local entity.

## Types of joint ventures

There are a number of legal structures which are sometimes referred to as a joint venture. The most commonly used are:

- (a) a partnership
- (b) a contractual joint venture (also known as an unincorporated joint venture)
- (c) a joint venture company (also known as an incorporated joint venture).

A contractual joint venture tends to be unusual at law – usually co-ownership will be treated as a partnership so really the two alternatives are whether the "joint venture" is run through a company structure (where the co-owners own the shares in the company) or whether the co-owners operate as a partnership.

## Partnership

Broadly, a partnership is a relationship which subsists between persons carrying on a business in common with a view to profit. If a partnership relationship arises, this relationship is governed by the contract between the parties and the general law, including the law

of partnership (in particular the Partnership Act).

A partnership deed usually governs the specifics of the partnership including things such as the objectives of the partnership, each party's contribution, each party's rights and obligations, the rules setting down how the partnership will operate including the management structure, the term, the distribution of profits, events of termination, and how to deal with disputes.

There are several characteristics of a partnership which prospective participants may wish to look at in detail.

- (a) Risk - each partner is jointly and severally liable for all the debts of the partnership, with no limited liability. Accordingly, a third party's claim against a partnership can be enforced against any partner, leaving that partner to collect from the other partners if possible.
- (b) Binding nature - generally, a partner who makes a commitment on behalf of the partnership binds the partners to perform that commitment as far as third parties are concerned (regardless of whether the partnership deed limits that authority or not).
- (c) Fiduciary relationships - each partner is a fiduciary to the other partners. Accordingly, a partner cannot obtain a personal profit from the use of property, information or opportunities which become available to it in the course of partnership activities without the consent of the other partners.
- (d) Accounting flexibility - in New Zealand, every partnership is a separate business for tax purposes, although the net profit or losses are attributed to the partners in agreed shares. Accordingly, a single set of accounting policies must be established for tax purposes. Individual partners cannot adopt their own policies for matters such as depreciation and other discretionary issues.

## Contractual joint venture

A contractual joint venture is a form of association established by agreement between the parties and is a creature of that agreement. It is not a company and therefore is not a separate legal entity from the participants, and it is not intended to be a partnership. Accordingly, restrictions imposed by the Companies Act and the Partnership Act do not apply.

The key difference in concept between a partnership and a contractual joint venture is that in a contractual joint venture, the parties both put in assets, have separate interests in these assets and continue to carry on separate businesses (with a common goal). In a partnership, the businesses of the parties merge and are run in common. Also, partners do not have a separate interest in the assets. Like partnerships, usually parties under a contractual joint venture share profits and losses in proportion to their respective interests.

If the parties are not in partnership then in theory at least, an unincorporated joint venture structure means that the parties are not jointly liable for each others'

liabilities and each party cannot bind the other. However, as discussed, whether a relationship in fact amounts to a partnership is a question of law – even if the parties expressly say they are not in partnership that is not necessarily the case. Usually, an unincorporated joint venture will be treated as a partnership.

#### Joint venture company

The term “joint venture company” is generally used to describe the situation where parties get together and form a company to use as a vehicle for carrying out some activity. The parties operate through the company and have shares in the company in their respective portions. The assets of the company belong to the company, not the shareholders, and the profits of the company are shared by the shareholders in proportion to their share.

The provisions of the Companies Act, which impose obligations and restrictions on companies, apply to joint venture companies.

#### **Documenting the arrangement**

Generally, the participants of a contractual joint venture and a joint venture company enter a joint venture agreement/shareholders agreement to regulate their relationship. Each agreement will cover similar issues which will usually include the following:

- (a) Statement of joint venture activity and objectives – this lists the general objectives of the venture with some degree of detail.
- (b) Conditions to the agreement (if any) – for example, one party may have the right to review the legal aspects, including the zoning, relating to the land proposed to be purchased in order to be satisfied that the land is suitable, before entering the agreement.
- (c) Term of the venture (ie how long will the relationship/investment last) including methods of termination.
- (d) Raising of initial capital and continuing capital.
- (e) Ownership of interests and profit share.
- (f) Auditors – Auditors are usually appointed because of the potentially conflicting interests of the joint venture parties on financial matters.
- (g) Decision making – the structure of the management committee (contractual joint venture) and the board of directors (joint venture company) need to be dealt with.
- (h) Confidentiality – it may be worthwhile considering the requirement for a confidentiality agreement to be entered by the parties before any meaningful business or technical discussions in respect of the venture begin.
- (i) Default and dispute resolution.
- (j) Good faith obligations.

Further, the participant will also usually enter a management agreement setting out how the entities operations will be carried out. This may provide for matters such as what sort of silvicultural regimes will be adopted in order to meet target markets, when and how such regimes are to be implemented, when and

how harvesting is to take place, marketing efforts and sale.

By virtue of the Companies Act, a joint venture company will also have a constitution which should give effect to the shareholders' agreement. Joint venture companies also need detailed provisions dealing with shareholdings including pre-emptive rights on the issue or transfer of shares. For example, a requirement may be that new shares in the company will be offered to shareholders pro-rata on a pre-emptive basis. A similar provision may exist for a party selling any of its shares.

It is imperative that the relationship is accurately and effectively defined at the outset. If this fundamental requirement is neglected and matters such as ownership and profit sharing, parties' rights and obligations, management and decision making, and dispute mechanisms are poorly dealt with, then the risk of irreconcilable disputes occurring is a very real threat which may defeat the common purpose of the venture.

#### **Contractual joint venture or joint venture company?**

In determining whether to enter a contractual joint venture or a joint venture company the following factors will be relevant:

- (a) Risk - the liability of shareholders within an incorporated joint venture is generally limited to the capital that they have invested in the company as shares. Accordingly, a third party cannot generally claim against a shareholder in an incorporated joint venture. This is seen as a major advantage that a joint venture company has over a contractual joint venture.
- (b) Privacy - an unincorporated joint venture agreement is a private arrangement and therefore is not subject to public scrutiny like the constitution of an incorporated company.
- (c) Familiarity - the nature of the business or the attitude of one or more parties may lead to a choice of incorporated entity. The framework provided by corporate law and protection available to shareholders may be preferred in practice as an additional safeguard to contractual rights.
- (d) Accounting flexibility - partners may prefer an unincorporated venture allowing them to keep separate accounts and maintain their own accounting policies. When the participants are involved in a high risk venture, where losses or early losses are likely, there is no satisfactory way of passing the losses back to the participants from a company. However, losses made by a contractual joint venture can be channelled back to the participants for tax purposes and offset against their income. This is often seen as a major advantage of a contractual joint venture over a joint venture company.
- (e) Legislative requirements - under a contractual joint venture, parties are free from many of the restrictions of the Companies Act so that parties can incorporate whatever provisions they wish to deal with

the decision making procedures, authorities, assignment of interest, defaults and other arrangements without the restrictions of such legislation.

- (f) Transfer of interests - it is easier to transfer shares to incoming parties which is a big advantage of an incorporated joint venture. Because it tends to be specific as to the parties needs, a transfer of shares is unusual once the joint venture is fully operational.
- (g) Financing - if the parties want to use collective financing and grant security over the joint venture assets, a company can be an advantage. Also, partly paid up shares can be issued as a way of securing further capital.
- (h) Fiduciary relationships - shareholders within an incorporated joint venture would not ordinarily have concern unless special provisions are inserted into the joint venture agreement.

#### **Joint ventures with foreign investors**

If you propose to enter a joint venture with a foreign person or company to purchase land over five hectares in area, and the foreign body will have a share of 25% or more of the joint venture, then it is likely that the consent of the Overseas Investment Commission (OIC) will be required before this transaction can properly proceed. This requires submitting an application to the OIC who will decide if the applicant meets the investor test and whether the investment is in the national interest.

#### **Appropriate ownership structure**

The appropriate ownership structure in a particular situation is determined by a number of factors which may include availability of suitable finance, tax considerations, bargaining positions of the various participants and the requirements of the parties in terms of liability.

If a form of joint venture is contemplated, the parties must ensure that the arrangement is accurately and effectively formally documented at an early stage.

#### **Applicants for Registration**

The following have applied to become a Registered Members of the NZIF, with the extension to become Registered Forestry Consultants

Mark Belton	Christchurch
Piers MacLaren	Christchurch
Stef Kincheff	Rotorua
Geoff Cameron	Wellington
Brian Rawley	Tokoroa

The following have applied to have their five-yearly consultant review:

John Schrider	Tawa, Wellington
Paul Malloy	Nelson

The Registrar, NZIF Registration Board,  
PO Box 1340, ROTORUA.

## **Calendar 2000**

The following conferences, expos, courses and other events will be of interest to readers. Details are brief, so please contact the organisers for more information.

#### **Study, conservation and utilisation of the forest resources. 3rd Balkan Scientific Conference. Sofia, Bulgaria.**

2-4 October 2001

Contact: Prof. Tsveta Naydenova, Forest Research Institute, Bulgarian Academy of Sciences, 132, St. Kliment Ohridski Blvd., BG-1756 Sofia, Bulgaria.  
Tel: +359-2-6222961; Fax: +359-2-6222965;  
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#### **New Zealand Forest Expo 2002**

The four-yearly expo and conference of New Zealand forest industries.

Key dates include:

#### **12-13 March 2002**

FI2002 Conference

#### **14-16 March 2002**

FI2002 Exhibition

#### **18-21 March 2002**

Appita Conference (Australasian Pulp and Paper Industry Technical Association)

Key contacts for the expo and conference

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