Mining joint ventures
By Angus Macdonald

Introduction

During the resources boom of 2002 to 2007 exploration joint ventures were a popular structure for junior miners to raise funds to develop green and brownfield mining projects. The incoming party would farm-in, earning an interest in the project by paying exploration expenditure up to a pre-agreed level for its ownership interest giving the owner of the mining tenements farming-out valuable capital, expertise and, in some cases, a guaranteed market for its product.

The market is now very different – falling commodities prices, the high levels of debt amongst mining companies and the lack of competitive finance has left many mining companies struggling financially. However, to combat the high cost or, in many cases, non-availability of credit and to avoid having to mothball projects as a result, miners may once again wish to consider whether they can develop their projects in a joint venture arrangement.

With the announcement that BHP Billiton will pay Rio Tinto US$5.8 billion for a 50/50 joint venture interest in the companies' Western Australian iron ore assets, to achieve synergies, share infrastructure and, in Rio Tinto's case, help relieve its current debt burden, it is clear that joint ventures are a viable financing alternative for major and junior miners alike in the current economic climate.

The purpose of this article is to describe the key legal features of joint ventures as an investment structure in the mining industry and their comparative advantages and disadvantages.

Key features of joint ventures: comparative advantages and disadvantages

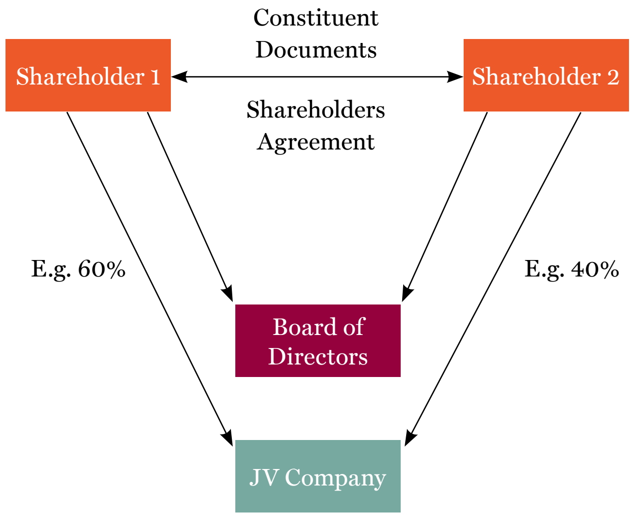
Joint ventures have been devised not only to provide convenient structures for bringing together capital and expertise on a large scale, but also to achieve a satisfactory position under tax and trade laws.

Joint ventures comprise either the incorporated, or equity, joint venture ("**EJV**") and the unincorporated, or contractual, joint venture ("**UJV**").

(a) Incorporated or equity joint venture

An EJV is set up by the incorporation of a company under the relevant companies legislation or code. The participants in an EJV are shareholders in the joint venture vehicle, which is a separate legal entity from the participants.

A typical EJV structure is set out below:

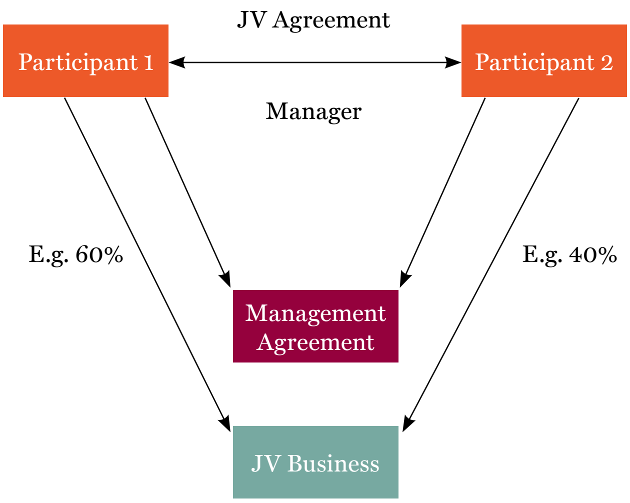


The **Appendix** sets out a summary of the key features of an EJV.

(a) **Contractual or unincorporated joint venture**

A UJV is created under general contract law. There is no separate legal entity constituted, although sometimes a company may be set up to perform subordinate functions for the venture, such as to manage the venture. The distinguishing feature of a UJV is the entitlement of each participant to take in kind its share of the joint venture production (ore) in proportion to its joint venture interest (rather than in the form of a share in profits or in dividends).

A typical UJV structure is set out below:



The **Appendix** also sets out a summary of the key features of a UJV.

(c) **EJV structure: pros and cons**

(i) **Advantages of an EJV structure**

The main advantages of an EJV are:

Limited liability: As an EJV takes the form of a company incorporated under the relevant companies legislation or code, all the obligations of the venture are borne by the company, and do not flow through to the shareholders (the participants). The general rule is that shareholders are only liable for their paid-up share capital.

Simplified collective financing: Generally, an EJV company through its directors deals with borrowings and security on behalf of the EJV; there is no need for each of the participants to make their own financing arrangements. The contributions by the participants may be by way of purchasing shares in the EJV company or making loans to the EJV company.

Transferability of interests: In an EJV, the interest of each of the participants is clearly defined by the number of shares that they hold. Typically, shares are freely transferable, although it is also common for participants in an EJV and the EJV's project financiers to restrict transferability to retain control.

Highly regulated management structure: The management and administration of an EJV company is usually well defined by its constitution, the provisions of the relevant companies legislation or code and established general law principles.

(ii) **Disadvantages of an EJV structure**

Trapped tax losses: Any tax losses belong to an EJV rather than its shareholders. Unlike a UJV, tax losses of an EJV cannot be offset against profits derived in other ventures in which a shareholder may separately participate.

Inability of individual shareholders to influence the tax position of the EJV company: As an EJV company is a separate entity, it has to file a tax return in its own right. The tax position of its shareholders has no bearing on an EJV company. As noted above, tax losses are trapped in the EJV company itself and cannot be used by its shareholders.

Potential capital gains tax liability: There are likely to be capital gains tax consequences if a participant intends to transfer its assets (such as mining tenements) into a new EJV company.

Inability to stream cash flow to individual participants except where dividends are declared: As a shareholder, an EJV participant does not have the right to the cash flow or the product of an EJV- shareholders only have a right to dividends. The amount and whether dividends are declared is decided by the directors of an EJV company. Participants are not guaranteed seats on the board of directors and strategic involvement, although some of these matters may be agreed in a shareholders agreement. The declaration of dividends is generally deferred until debt financing is greatly reduced or paid out. Participants do not have an automatic right to the product at cost price. Any product obtained will be at market price.

(d) **UJV structure: pros and cons**

(i) **Advantages of a UJV structure**

The main advantages of a UJV are:

Direct and separate legal and beneficial interests in joint venture assets: In a UJV, each of the participants holds a proportionate undivided interest in the property and liabilities of the venture as tenants in common.

Separate liability: As the relationship between the participants in a UJV is contractually defined, generally the liability of each participant to contribute to expenditure and to discharge liabilities of the venture can be clearly defined and limited. Participants are generally only liable for their own respective obligations and liabilities arising under the UJV agreement (i.e. severally liable and not jointly and severally liable).

Management: The administration and management of a UJV is subject to fewer statutory duties, restrictions and requirements than an EJV. The participants are free to negotiate the manner in which they would like administration and the management of the UJV to be carried out. Commonly, the responsibilities for management will be conferred on one or more of the participants, or on a company owned by some or all of them or on a third party who acts as the manager of the venture. Typically, a UJV features a policy or management committee which is responsible for all major decisions. Each participant is entitled to be represented on the policy committee and often major decisions require the unanimous vote of all participants, regardless of ownership levels.

Entitlement to production from the joint venture operations: Each participant is only entitled to a share of product rather than profits, which enables each participant to sell its share of ore produced as and when it sees fit, and thereby separately generate profits. Participants therefore have greater control over their cash flow and profits.

Separate responsibility for tax treatment: As the UJV has no separate legal status under law, liability for taxation resides directly with the participants in the joint venture. Each participant can include its joint venture interest as part of its consolidated accounts. The participants are therefore usually free to treat available expenditures and tax deductions (including depreciation) as they see fit, including by off-setting against assessable income from all sources. Participants can transfer losses to other members of a corporate group, and generally have greater freedom to arrange affairs in the most tax advantageous manner.

Fewer restrictions on financing the venture: Each participant is free to make its own financing arrangements and to charge its joint venture interest accordingly. Normally, each participant makes independent financing decisions but grants a cross charge to the other participants to secure against defaults between them.

Security for financing: Security in a UJV is generally provided by the individual participants' and comprises their respective sales proceeds of the ore produced and ownership share of the joint venture assets.

(ii) **Disadvantages of a UJV structure**

It can be said that the main disadvantage of a UJV is that it requires preparation of detailed legal documentation to set out the rights and obligations of the participants.

An EJV agreement (i.e. shareholders agreement) is less complex because it does not contain the full scope of the deal. In structuring an EJV, the provisions of the relevant companies legislation or code and the legal principles established under the general law must be taken into account. Whereas a UJV is permissive, an EJV must be restraining if you wish to avoid an arrangement which local companies legislation would otherwise dictate, e.g. declaration of dividends, majority resolutions, etc. Problems inherent in an EJV would be further compounded if a participant takes a minority shareholding as it might not be able to block special resolutions, unless the shareholders agreement provided otherwise.

(e) **EJV v UJV: other considerations**

There are arguments in favour of participants establishing a joint venture as an incorporated entity when planning to list a vehicle in the future. In this regard, utilising one incorporated entity provides the basis for "clean listing" and means asset transfers would not be in issue prior to any public offering.

However, we note it is also possible for one joint venture participant to list its own company vehicle (where such entity holds an interest in a particular mining project under a contractual joint venture).

Hybrid structures are also possible. For example, the shareholders agreement (in an EJV) may provide for a separately constituted policy or management committee represented by participants (shareholders) in their participating interest (similar to a UJV structure). This gives the participants (shareholders') through their committee representatives a direct role in the management of the JV.

As ever, early advice on structure should be sought to allow informed development of the preferred investment strategy, due diligence and documentation.

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Appendix

Key features of unincorporated and incorporated joint ventures

	Feature	Unincorporated joint venture	Incorporated joint venture
1.	Establishment	By contract	Incorporation of a company (the **"JV Company"**)
2.	Applicable law	General contract law	Companies legislation/code in the relevant jurisdiction
3.	Nature of the joint venture vehicle	No separate legal entity	Separate legal entity
4.	Liability	With the participants individually	Limited to the JV Company
5.	Participation	As parties to the joint venture agreement	Shareholders in the JV Company
6.	Legal relationships	As defined by contract	• Participants as shareholders in the JV Company • Participants and the JV Company • Directors of the JV Company and the shareholders
7.	Documentation	Requires detailed negotiation and drafting	Less documentation because local companies law applies
8.	Management	Flexible: may be by a management company set up by the participants or one or more of the participants. Policy/ management committee responsible for major decisions.	Board of directors: highly regulated by the JV Company constitution and shareholders agreement (where applicable).
9.	Assignment of JV interest	As defined in the joint venture agreement	By share transfer.
10.	Assets of the JV	Each participant has a direct and separate legal and beneficial interest as tenant in common.	Belong to the JV Company.
11.	Off-take of JV Product	Entitled to product corresponding with percentage interest in the joint venture at cost price.	No automatic right to product at cost price.

12.	Profits/Cash flow	Profits from sale flow directly to participants individually.	Profits/cash flow cannot be streamed to individual participants except where dividends are declared.
13.	Tax losses and deductions	Reside with each participant individually.	Trapped in the JV Company (not transferable to the shareholders).
14.	Capital gains tax ("**CGT**")	Participants own assets directly: CGT liability can be set off against any other capital losses of the participants individually.	JV Company subject to CGT upon disposal of JV Company assets.
15.	Return on investment	Direct return in revenue according to percentage interest.	Indirect through declaration of dividends (controlled by the JV Company board of directors).
16.	Project financing	Each participant is free to take and sell its share of ore produced by the joint venture and grant security over sales proceeds to its respective financiers.	Declaration of dividends generally deferred until debt financing greatly reduced or paid out.

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