SECURITIES OVER ESOTERIC PROPERTY

Security over a joint venturer's rights and interest in an unincorporated joint venture

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1. INTRODUCTION

This paper focuses on some of the principal issues which can arise where a participant in an unincorporated joint venture borrowers, for the purpose of financing its contribution to the venture, on the security of its interest in the joint venture assets.

It will be assumed for this purpose that the financiers will look for payment principally to the borrower's share of the joint venture product or cash flow and to their security over the borrower's interest in the joint venture assets.

2. UNINCORPORATED JOINT VENTURES

An unincorporated joint venture is an association of investors which lacks both corporate form and equity capital. It is frequently called a contractual joint venture. It is brought into existence by a contract (the joint venture agreement) under which investors undertake a joint commercial activity. The joint venturers often hold their interests in the joint venture property directly (for example, as tenants in common) although, to facilitate dealings with third parties and the administration of the joint venture itself, there is frequently interposed on the title to the property a nominee which holds the property as bare trustee and also sometimes serves as the manager of the joint venture.

Unincorporated joint ventures can be further categorised into:

- those which are partnerships; and
- those which are not.

3. DOES THE JOINT VENTURE AS A MATTER OF LAW CONSTITUTE A PARTNERSHIP?

It is an important question from a financing viewpoint whether the joint venture as a matter of law constitutes a partnership. If the joint venture is in legal reality a partnership, significantly different security considerations will apply. The main considerations from a lender's viewpoint stem from various well-established principles of partnership law which are as follows:

(i) A partner generally has power to pledge the credit of fellow partners (thereby giving rise to a claim against the partnership assets ranking ahead of separate creditors)[1] within the scope of the partnership business.[2] A joint venturer is usually denied this power by the joint venture agreement.

(ii) Every partner has a right to have partnership property applied in payment of the debts and liabilities of the firm. The various State *Partnership Acts* recognise this right on the occasion of the dissolution of the partnership.[3] This right is often described as a lien over partnership property. By way of contrast, joint venturers have no such lien as is enjoyed by partners. In practice under the terms of the joint venture agreement, the rights of a chargee taking under security given by the joint venturer are subject to the rights of the other venturers, which rights may include a prior cross charge on at least some of the venturer's property.

(iii) A partner has no title to specific partnership assets. A financier seeking security in support of a transaction entered into by partners may seek security over essentially two types of property:

   (a) the individual interest of a particular partner in the partnership;

   (b) a particular item of partnership property.

   Problems arise in identifying in each case the precise nature of the property to be secured.

   The High Court has confirmed that a partner's interest in a partnership encompasses two aspects: it covers both a right to receive the profits while the partnership is a going concern and a right to share in the surplus (if any) in a winding up of the partnership after realisation of the assets and payment of the liabilities to unrelated persons who have dealt with the partnership.[4] This interest or share is an equitable chose in action belonging to the partner and can, for example, be assigned by way of security either at law or in equity. A lender taking security of this kind should, however, be made aware that the provisions of the various State *Partnership Acts* preclude the lender as assignee under such an assignment from exercising any managerial function in respect of the partnership.[5] Another relevant issue from the financier's perspective is that the security, whether mortgage or charge, cannot give the financier any interest in the assets of the partnership prior to dissolution which would enable it to prevent the disposal of those assets by the partners in the ordinary course of business.[6]

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1 Section 110 *Bankruptcy Act* 1966 (Cth).

2 Section 5 *Partnership Act* 1892 (NSW); section 9, *Partnership Act* 1958 (Vic); section 5, *Partnership Act* 1891 (SA); section 8, *Partnership Act* 1891 (Qld); section 26, *Partnership Act* 1895 (WA); section 10, *Partnership Act* 1891 (Tas); section 9 *Partnership Ordinance* 1963 (ACT).

3 Section 39, *Partnership Act* 1892 (NSW); section 43, *Partnership Act* 1958 (Vic); section 39, *Partnership Act* 1891 (SA); section 42, *Partnership Act* 1891 (Qld); section 50, *Partnership Act* 1895 (WA); section 44, *Partnership Act* 1891 (Tas); section 45, *Partnership Ordinance* 1963 (ACT).

4 *Federal Commissioner of Taxation v Everett* (1980) 143 CLR 440.

5 Section 31, *Partnership Act* (NSW); section 35, *Partnership Act* 1958 (Vic); section 31, *Partnership Act* 1891 (SA); section 34, *Partnership Act* 1891 (Qld); section 42, *Partnership Act* 1895 (WA); section 36, *Partnership Act* 1891 (Tas); section 36, *Partnership Ordinance* 1963 (ACT).

6 *United Builders Pty Ltd & Anor v Mutual Acceptance Ltd* (1980) 33 ALR 1 at 10.

The principal problems confronting a financier wishing to take security over property seemingly owned by the "partnership" are:

- the identification of what property is to be regarded as partnership property; and
- the nature of the partners' interest in that property.

The first issue is addressed by the various *Partnership Acts* which state that the partnership property is composed of:

> "all property, and rights and interests in property, originally brought into the partnership stock or acquired, whether by purchase or otherwise, on account of the firm, or for the purposes and in the course of the partnership business."[7]

Whether property has been brought into the partnership is a question of fact and is to be answered by looking at the intention of the parties as demonstrated by the partnership agreement (if any) and by the manner in which they have treated the property.[8] If property is to be brought into the partnership, a problem arises since it cannot be held by the partnership, which is not a separate legal entity, and accordingly cannot hold property in its own name.

In the real property context, there will generally be no difficulty where all partners are noted on the title to the asset to be mortgaged. However, where (as is often the case) legal title to partnership property is held by only one or at least not all of the partners, the partners holding the title to the partnership property do so in trust for the other partners. That trust would presumably only be a bare trust (the trustee of which normally has only very limited powers) subject to the additional statutory requirements in the various *Partnership Acts*[9] that the partnership property must be held and applied by the partners exclusively for the purpose of the partnership and in accordance with the partnership agreement. It could therefore be argued that the partner(s) in whose name the partnership property is held will only have recourse to the partnership property if the transaction is entered into by him or her in accordance with that obligation. Ratification of the grant of the security by all current partners is therefore important to remove the potential problem that the partner(s) granting the security did not have the authority to bind the remaining partners.

In contrast to that of a partner, a joint venturer in an unincorporated joint venture generally has in the first instance, a proprietary interest in each of the joint venture assets as a tenant in common and, secondly, certain rights or choses in action represented by the joint venture agreement and related agreements.

(iv) The claims of partnership creditors against partnership assets have priority over the claims of creditors of each separate partner.[10] If the joint venture is in legal reality a partnership, it follows that the lenders cannot obtain a security over the borrower's interest in the property of the joint venture which will enjoy priority over other joint venture creditors.

It is important, therefore, that the distinction between joint ventures and partnerships be maintained.[11]

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7 Section 20, *Partnership Act* 1892 (NSW); section 24, *Partnership Act* 1958 (Vic); section 20, *Partnership Act* 1891 (SA); section 23, *Partnership Act* 1891 (Qld); section 30, *Partnership Act* 1895 (WA); section 25, *Partnership Act* 1891 (Tas); section 24, *Partnership Ordinance* 1963 (ACT).

8 *Harvey v Harvey* (1970) 120 CLR 529; *Kelly v Kelly* (1990) 64 ALJR 234.

9 See footnote 7.

10 Section 110, *Bankruptcy Act* 1966 (Cth).

11 As to what constitutes those critical distinguishing features, see A M Millhouse, "Financing Joint Ventures", Chapter 5 *Joint Ventures Law in Australia* 1994, W D Duncan (Ed) at pp 135-138.

4. IS THERE A CERTAIN AND ENFORCEABLE JOINT VENTURE AGREEMENT?

One point which must always be borne in mind, in the context of unincorporated joint ventures, is that they derive their genesis from a contract, whether it be express or implied. Financiers will therefore wish to confirm the precise terms and conditions of the joint venture agreement which the borrower might allege is in existence.

In this context, it is of use to briefly consider "heads of agreement" and "letters of intent" which are often both misunderstood and misapplied, notwithstanding their widespread use in many joint venture situations. The basic issue when confronted with an intended heads of agreement or letter of intent is to ascertain precisely the parties' intentions. The parties may intend either to be bound or not to be bound in contract by the heads of agreement or letter of intent.

If the parties do intend to be bound, then there are two further alternatives:

(i) That contractual obligations are intended to take immediate effect notwithstanding the further intention that a brief or informal document will be replaced by one of greater detail and/or formality; or

(ii) That binding contractual obligations are intended to be suspended, pending preparation of the more detailed and/or formal documents.[12]

The courts do not dispute that heads of agreement or an agreement to enter into a joint venture can amount to a contract which gives rise to damages in the event of a breach.[13] The court will examine the words used in the document in order to ascertain whether the parties intended to be contractually bound by the heads of agreement.[14] It has even been suggested that a statement in a heads of agreement whereby the parties promise to negotiate in good faith to formulate a joint venture agreement can, in certain limited circumstances, be contractually enforceable. This may occur where the parties intend to create binding legal obligations and where an identified third party is given the power to settle ambiguities and uncertainties arising during the negotiations.[15]

The dividing line between cases where a court might hold that the preliminary arrangement is binding and those where it is not is frequently fine; ultimately, it is a matter of what the parties intended. Clearly, intending joint venturers should refrain from entering into heads of agreement or letters of intent unless the document clearly and unambiguously states the parties' intentions. The law reports are littered with a plethora of cases which illustrate that intending joint venturers are frequently disadvantaged because their proposed rights and obligations are either not recorded in a detailed written agreement at all, or are couched in a carelessly drafted informal document that does not address all significant issues.[16] A prudent financier will wish to ensure that an appropriate and binding joint venture agreement is in place before committing to advance any funds.

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12 *Masters v Cameron* (1954) 91 CLR 353.

13 *Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd* (1991) 24 NSWLR 1; *ITD Innovation & Technology Development Pty Ltd v Angus & Coote Pty Ltd*, unreported, Sup Ct Vic, Beach J, 4th June, 1991.

14 *Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd*, supra at page 26.

15 *Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd*, supra at pages 26-27.

16 Some recent examples include *Petroz (Timor Sea) Pty Ltd v Zoc 91-12 Pty Ltd* (unreported, Supreme Court of Queensland, Williams J, 21 September, 1993, No 291 of 1993); *Amphora Investments Pty Ltd v Carlton & United Breweries (Qld) Ltd* (unreported, Supreme Court of Queensland, Williams J, 22 October, 1990, No 4569 of 1987); *Vroon BV v Fosters Brewing Group Limited* (unreported, Supreme Court of Victoria, Ormiston J, 11 March, 1993, No 2097 of 1991); *Murchison Mining Co Pty Ltd v Radman Mining Pty Ltd* (unreported, Supreme Court of Western Australia, Ipp J, 15 July, 1994, No 2155 of 1992); *Strang Patrick Stevedoring Pty Ltd v James Patrick & Co Pty Ltd* (unreported, Supreme Court of New South Wales, Giles J, 3 March, 1993, No 50295 of 1992).

Financiers must also bear in mind that parties to a joint venture agreement may effect a variation of the agreement by modifying or altering its terms by mutual agreement. The terms of a joint venture agreement may be varied by a subsequent agreement, whether oral or written, unless the joint venture agreement is one required by law to be evidenced by writing, in which case it can only be varied by writing.[17]

Because of the importance of the terms and conditions of the joint venture agreement, it will be usual for the financier to insist that the borrower warrant, among other things, that:

(a) copies of all joint venture and other relevant project infrastructure agreements have been provided to the financier and that there are no breaches of those agreements;

(b) the entry into the proposed financing and the granting and enforcement of the proposed securities will not breach any provisions of the above agreements.

5. THE RELATIONSHIP BETWEEN THE LENDERS AND THE JOINT VENTURERS

5.1 Some problems with a several financing

In the joint venture financing context, the financier's lawyers must recognise at the outset the importance of two distinct levels of documentation:

(i) project infrastructure agreements usually entered into by the project developer with third parties such as project tenure leases, constructions agreements, sales contracts, transport agreements to access rail and port facilities, any other agreements providing services to the venture (for example, roads, electricity, water), cross-charges given by the other venturers and the joint venture agreement itself;

(ii) credit and security documents between the project developer and the financiers.

The financiers will need to consider the extent to which particular assets should be the subject of legal mortgages, or fixed or floating equitable charges. Financiers will usually wish to be granted as a minimum fixed charges over the borrower's interest in assets which are not normally sold or disposed of in the ordinary course of the joint venture operations.

The financiers would normally seek security over the whole array of project infrastructure documentation (comprising mainly intangible contractual rights) so that, in the event of default, the lenders can either operate or sell the project (preferably as a whole). The financiers will also wish to take security over the borrower's entitlement to joint venture cash flow or product arising from the operation or completion of the joint venture. The financier's security may therefore extend to an assignment or charge of the borrower's interest in various sales contracts.[18] In this context, financiers would normally prefer to structure the financing to the joint venture participants on a joint, rather than several, basis because:

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17 *United Dominions Trust (Jamaica) Ltd v Shoucair* [1969] 1 AC 340; *Suttor v Gundowda Pty Ltd* (1950) CLR 418 at 440; *Tallerman & Co Pty Ltd v Nathan's Merchandise (Vic) Pty Ltd* (1957) 98 CLR 93 at 112-13, 122.

18 As to some of the issues that can arise in taking security over a borrower's interest in sale contracts, see Millhouse, supra, at pp 148-150. If a charge over sales contracts is contemplated, a specific fixed charge (if effective) is preferable to a floating charge because a specific charge confers an immediate equitable interest in the present and future debts, the subject of the sales contracts, thereby entitling the chargee to preserve priority by giving notice of its interest to, and compelling payment of sales proceeds by, the debtor, pursuant to the rule in *Dearle v Hall* (1828) 38 ER 475. A chargee under a floating charge is disqualified, whilst the charge remains floating, from giving notice under the above rule (*English and Scottish Mercantile Investment Co Ltd v Brunton* [1892] 2 QB 700).

(i) all joint venture assets and revenues can be more readily charged in favour of the lenders to secure repayment of the joint venture loans;

(ii) the lenders' default powers (especially receivership and sale) are more readily exercisable as the securities embrace the whole project (a factor which would ordinarily widen the field of available purchasers). The prospect of confrontation with belligerent non-defaulting joint venturers is also thereby avoided;

(iii) a joint financing removes many of the difficulties which would otherwise be confronted when structuring the joint venture agreement; and

(iv) in a several financing, a single joint venturer may not be able effectively to covenant to complete the joint venture. It is not of much value to lenders to have a strong covenant from the borrowing venturer to use its voting power in favour of completion and against abandonment, unless, in the joint venture agreement, the other venturers commit to complete and not to abandon, in similar terms. The lenders are not ideally protected unless the other venturers also charge their interests in the joint venture to secure repayment of the borrowings, but this is of course most difficult to negotiate where there are wholly independent joint venturers.

As part of preparing the financing structure, the lenders must satisfy themselves that the relevant joint venture and related project agreements are sufficiently comprehensive and enforceable, not only from the point of view of the parties to the documents, but also in the context of security enforcement. It is also essential for security integrity to ensure that the joint venture and other project infrastructure documents remain on foot and unaltered during the term of the financing.

It must also be borne in mind that when taking security over a joint venturer's rights in an unincorporated joint venture, a conflict exists between the interests of the lenders, who are anxious to ensure that they will be able satisfactorily to enforce their securities in the event of default, and the interests of the other venturers, who are concerned that the lenders may exercise default powers to their detriment.

5.2 The joint venture agreement - matters of frequent concern to lenders

From the financier's perspective, the joint venture agreement is the crucial document in terms of:

(a) establishing the joint venturers' respective rights and interests in the joint venture;

(b) establishing the joint venturers' respective entitlement to the product or property generated or developed by the joint venture;

(c) defining a joint venturer's rights to assign and charge its individual interest in the joint venture;

(d) providing for the consequences of a default by a joint venturer; and

(e) identifying the financier's rights, particularly as regards the non-defaulting joint venturers, when enforcing its securities in a default situation.

Lenders, therefore, need to carefully consider the terms of the joint venture agreement to ensure that their interests will be adequately protected. Obviously, the matters likely to cause concern will vary from project to project and between financiers. However, the following list comprises matters which are of frequent concern to lenders.

The joint venturer's interest in the joint venture and security of tenure

In a limited recourse financing, the financier's security generally comprises charges on:

(a) the joint venturer's interest in the joint venture, which will include its interest as tenant in common in the joint venture property and its interest in the choses in action comprising the joint venture agreement and other project agreements; and

(b) the joint venturer's share in the joint venture product, sales contracts and proceeds thereof.

It is therefore obviously imperative for the lender to be satisfied that:

(a) the borrower and the other joint venturers enjoy good title to the joint venture property and long term security of tenure. The possibility of native title claimants must not be overlooked;[19]

(b) under the joint venture agreement the joint venturers have appropriately agreed the shares in which title to the joint venture assets is to be held and that they shall be severally liable for joint venture debts to the extent of those shares;

(c) the joint venturers have covenanted not to partition, by order of a court or otherwise, any of the jointly owned joint venture assets. Most joint venture agreements should therefore contain waiver clauses excluding or limiting the right to seek partition or to apply to the courts for a statutory trust for sale.[20] Any such clause should be carefully drafted as there is significant scope for a court to hold that the clause is void as a restraint upon alienation or the clause does not circumvent the right to apply for a statutory trust for sale.[21] To overcome this problem, the prohibition on partition has in some large joint venture projects occasionally been included in an agreement with Government (a State agreement) and given statutory force;[22]

(d) the operations of, and therefore the cash flow generated by, the joint venture are unlikely to be significantly altered by governmental interference or directions under statutes regulating the industry in question.[23] It may be necessary in these circumstances to minimise these risks by specific exclusions in a State agreement or other specially enacted legislation.

The joint venturer's right to assign and charge its joint venture interest

As many of the joint venture assets will comprise contractual rights (under not only the joint venture agreement but also other agreements including, for example, sale agreements, State agreements, transportation and other infrastructure agreements), the lender will wish to ensure that the borrower's interest under those agreements are adequately charged to enable the lender to complete or continue the joint venture project in an enforcement situation. The benefit of a contract is a chose in

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19 Many project participants and their financiers may be potentially affected in this regard by the judgment of the High Court in *Mabo v Queensland* (1992) 175 CLR 1 or by complementary native title legislation such as the *Native Title Act*, 1993 (Cth), *Native Title (Queensland) Act*, 1993 (Qld), *Native Title (New South Wales) Act*, 1994 (NSW), *Land Titles Validation Act*, 1993, (Vic), *Confirmation of Titles to Land Request Act*, 1993 (NT), *Validation of Titles and Actions Act*, 1994 (NT), *Land (Titles and Traditional Usage) Act*, 1993 WA.

20 For example, pursuant to section 38, *Property Law Act* 1974 (Qld); see also *Re Permanent Trustees Nominees (Canberra) Ltd* [1989] 1 QdR 314.

21 *Hall v Busst* (1960) 104 CLR 206; *Saliba v Saliba* [1976] QdR 205; *Johnston and Halliday v Halliday* [1984] ANZ ConvR 652; *Nullagine Investments Pty Ltd v Western Australian Club Inc* (1993) 67 ALJR 739.

22 As to State agreements generally, see Millhouse, supra, at pp 154-5.

23 See, for example, section 58 of the *Petroleum (Submerged Lands) Act* 1967 (Cth) which empowers the designated authority to direct a licensee to increase or reduce the rate of petroleum recovery, and the provisions of the *Coal Industry (Control) Act* 1948 (Qld).

action which generally can be assigned both at law or in equity. However, this general right of assignment is often qualified in the case of joint venture agreements.

In the absence of any clause restricting assignment, it would seem that contractual rights and benefits may be freely assigned, absolutely or by way of security, unless they are too personal to be capable of assignment.[24] A joint venture agreement, involving elements of mutual confidence, fiduciary relationships and long term association for the development of the joint venture project, would normally be a contract incapable of assignment without the consent of the other joint venture parties.

The lender will therefore need to be satisfied that the borrower has the right to assign and charge its interest in the joint venture under the terms of the joint venture agreement and other related agreements. These rights need to be sufficiently comprehensive to permit the precise type of securities to be taken. A right to both assign and charge is usually necessary to cover the possible types of security which may be required and to facilitate the lenders' or a receiver's powers of sale upon default. Pending sale, the lender will also wish to be able (usually via a receiver appointed under its securities) to exercise the rights of the joint venturer, and (at the lender's option) to perform the joint venturer's obligations under the joint venture agreement.

However, it is sometimes overlooked that the rights of a joint venturer under a joint venture agreement are usually incapable of assignment, either absolutely or by way of security, without the consent of the other joint venturers. Most joint venture agreements commonly restrict outright assignment (which is usually effected by sale) directly, or indirectly by conferring pre-emptive rights in favour of the remaining joint venturers. Furthermore, because contractual obligations cannot without a novation be assigned, it is also common for most joint venture agreements to require any assignment of rights to be conditional upon the assignee assuming, in favour of the other joint venturers, the corresponding obligations of the assignor.

It can become problematic interpreting a clause which only restricts "assignments". Does such a clause preclude a mortgage or charge by way of security which does not contemplate a complete assignment or transfer of rights?

Although the consequences of taking a charge in breach of a contractual prohibition are uncertain, some authorities indicate that a charge given in breach of the clause may be totally ineffective.[25] Meagher, Gummow and Lehane proffer the view that the consequences of breaching a contractual prohibition upon charging or assignment will depend upon whether the prohibition clause can be categorised as a condition or a warranty. If the clause containing the prohibition can be classified as a warranty, then the breach, whilst not affecting the validity of the assignment, may confer on the third party contractor a claim for damages against the borrower. However, if the clause can properly be construed as a fundamental term or condition, as distinct from a warranty, a breach (whilst not automatically invalidating the assignment) may confer on the third party contractor the right to treat the breach as a repudiation and rescind.[26] In this latter situation, an alternative possible consequence is that the prohibition clause has the effect that a purported assignment will be simply ineffective and will confer no rights on the assignee.[27] The category into which a particular contractual right will fall is

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24 *Tolhurst v Associated Portland Cement Manufacturers (1900) Ltd* [1902] 2 KB 660 per Collins MR at 668.

25 *Helstan Securities Ltd v Hertfordshire County Council* [1978] 3 All ER 262, *Specialised Transport Pty Ltd v Dominiak* (1989) 16 NSWLR 657; *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd and Ors* (1993) 3 All ER 417.

26 See Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies*, 3rd ed, Butterworths Sydney at 200-203; see also Starke J G, *Assignment of Choses in Action in Australia* (1972) at pp 64-7 and Professor Goode, "Inalienable Rights" (1979) 42 *MLR* 553.

27 *Brice v Bannister* (1878) 3 QBD 569; *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd and Ors* (1993) 3 All ER 417.

a matter of construction to be resolved by applying the ordinary principles of construction.[28] The question in each case must turn on the terms of the agreement in question.

The House of Lords in the *Linden Gardens Trust Ltd* case was invited to change the common law by holding that a clause in a building contract prohibiting the assignment of the benefit of the contract was void as being contrary to public policy. It was submitted that it is normally unlawful as being contrary to public policy to seek to render property inalienable. Since contractual rights are a species of property, it was argued that the prohibition against assigning such rights was void as being illegal. It appears that nothing was urged in argument as demonstrating that such a prohibition was contrary to the public interest beyond the fact such prohibition renders the chose in action inalienable. The House of Lords recognised that certainly in the context of rights over land, the law does not favour restrictions on alienability; in the case of real property there is a defined and limited supply of the commodity and it has frequently been held contrary to public policy to restrict the free market. However, the House of Lords considered no such reasoning applied to contractual rights as there is no public need for an unrestricted market in choses in action. The House of Lords therefore held that there was no policy reason why a contractual prohibition on assignment of contractual rights (which has the effect of bringing the assignee into direct contractual relations with the other party to the contract) should be held contrary to public policy.[29]

It is axiomatic that this is an area where both borrower and lender should proceed cautiously and seek prior consents from all other parties to the agreement. As far as the lenders are concerned, advance consents to two transactions should be sought, the first being the granting of the mortgage or charge, and the second, a sale of the mortgaged property upon default by the lenders or receivers appointed by them under the security. It is often commercially difficult to negotiate the latter consent.

Consequences of default by a joint venturer

The lender will need to assess the consequences of default by a joint venturer. These can vary to include:

(a) loss of information rights;

(b) loss of voting rights;

(c) the imposition of high interest rates on overdue payment;

(d) the loss of entitlement to joint venture product or proceeds thereof;

(e) exercise of rights under joint venture cross charges to enforce the payment of outstanding contributions to the joint venture;

(f) dilution of the defaulting joint venturer's interest in the joint venture (the defaulter's interest is often reduced in accordance with a formula based upon its relative financial status in the joint venture at the relevant time);

(g) compulsory sale (sometimes effected by options to purchase) to the non-defaulters at a price determined by a formula or procedure set out in the joint venture agreement; or even

(h) forfeiture of the defaulting joint venturer's entire interest.

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28 *Bensten v Taylor Sons & Co (No 2)* [1893] 2 QB 274; *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd and Ors* (1993) 3 All ER 417.

29 [1993] 3 All ER 417 at 430-1.

Many default provisions will generally be unacceptable to lenders (eg forfeiture) because of their potential severity. Another issue about which the financier must be carefully satisfied is the question of timing. When should these default consequences take effect?

Usually a lender will require some reasonable delay before the exercise of any default powers so that it can consider the default and the economics of the project. The lender will also usually require an ability to be able to cure the default itself.

Enforceability of joint venture defaults

All of the abovementioned mechanisms for overcoming the inability or refusal of a party to meet its obligations, although set out in the joint venture agreement which is prima facie binding upon and definitive of the rights of the parties to it, may be set aside or modified by the courts in certain circumstances. It will be of common concern to both the lenders and the borrower that if another venturer defaults, the remedies available against it will be legally effective and will facilitate completion or continued operation of the project. In this context, a number of legal issues arise.

Does the default provision, alone or in conjunction with other provisions constitute a registrable charge[30] or does it constitute a voidable preference?[31] Will the provision be subject to equitable intervention on the principles of forfeiture or penalties? Will the provision be set aside by a liquidator?[32] Will the provision, where it incorporates an option to purchase juxtaposed with a cross charge, be treated as ineffective in equity as its exercise would, in substance, amount to a foreclosure out of court or an unlawful fettering of the mortgagor's equity of redemption.[33] In the context of equitable relief against penalties and forfeiture, the High Court in *Legione v Hateley*[34] has held that a party having a legal right shall not be permitted to exercise it in such a way that the exercise amounts to unconscionable conduct.[35]

Continuation of joint venture notwithstanding default

The lender will need to be satisfied that the joint venture can continue to be carried on notwithstanding a default by a joint venturer.

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30 Cross charges, eg, would normally be registrable as charges pursuant to section 262, *Corporations Law*.

31 Section 588FE, *Corporations Law*.

32 See, eg section 468, *Corporations Law*. See generally Roberts, "Default Clauses in Joint Venture Agreements in the Context of Sections 368, 451 and 200 of the *Companies Code*" [1987] *AMPLA Yearbook* 318.

33 As to the possible conclusions a court may reach in respect of these questions, see J R F Lehane, "Joint Venture Finance and Some Aspects of Security and Recourse" in R P Austin and R J Vann (eds), *The Law of Public Company Finance* (Law Book Co, Sydney, 1986) at 521-526; K D MacDonald "Joint Ventures - Breakdowns and Repairs Rights Upon Default" [1983] *AMPLA Yearbook* 209; Roberts, ibid.

34 (1983) 152 CLR 406.

35 As to default provisions generally, see also *Shiloh Spinners v Harding* [1973] AC 691; *Monarch Petroleum NL v Citco Australia Petroleum Ltd* (1986) WAR 310; *Offshore Oil NL v Southern Cross Exploration NL* (unreported), Supreme Court of New South Wales, 19 March, 1987); *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170; *Stern v McArthur* (1988) 165 CLR 489; *Esanda Finance Corporation v Plessing* (1989) 166 CLR 131; *AMEV Finance Ltd v Artes Studios Thoroughbreds Pty Ltd* (1989) 15 NSWLR 564; *CRA Limited v NZ Goldfields Investments* [1989] VR 873; *David Securities Pty Ltd v Commonwealth Bank of Australia* (1990) 23 FCR 1; *Mosaic Oil NL v Angari Pty Ltd* (1990) 8 ACLC 780 (affirmed on appeal, but purely on the particular wording of the relevant default clause, by the New South Wales Court of Appeal in an unreported decision handed down on 18 December, 1990); The Hon Justice M J R Clarke, "Penalties Forfeiture and Dilution" [1989] *AMPLA Yearbook* 1; J H Waite and D Dawborn, "Contractual Forfeiture of Joint Venture Interests: Are Such Clauses Enforceable?" (1990) 11 *OGLTR* 389.

Lenders' rights, powers and obligations in an enforcement situation

The lenders would wish to exercise their power of sale free from restrictions on disposal (for example, rights of pre-emption or forced sale in favour of non-defaulting joint venturers). Such restrictions can unnecessarily complicate a mortgagee sale process and may be legally ineffective if the sale price for the defaulter's interest in the joint venture is for an amount less than its market value. Lenders would be proscribed from committing to sell as mortgagee for less than market value in some jurisdictions.[36] From the lender's viewpoint therefore, the pre-emptive rights provisions should not apply to a sale by it as chargee.

The lender may, however, be prepared to give the non-defaulting joint venturers a specified period of time in which to purchase the defaulting joint venturer's interest in the joint venture for its market value, failing which the lender would be free to sell to any third party.

Joint venturer cross charges

In recent years, where the obligations of the joint venturers under a joint venture agreement are basically the same and involve each joint venturer contributing moneys to the joint venture to fund its activities, it has become common to oblige each joint venturer to grant in favour of the others a deed of cross-charge to secure the payment of those contributions.

Joint venture agreements often therefore include a provision which obliges each joint venturer to execute a deed of cross-charge in favour of the other joint venturers (and the manager, if there is one) to secure payment of all amounts due and payable by the chargor under the terms of the joint venture agreement. The chargor usually charges its present and future:

(a) interest in the joint venture;

(b) rights and benefits under the joint venture agreement and any related agreements;

(c) right, title and interest in and to all joint venture property;

(d) all present and future proceeds of insurance taken out pursuant to the joint venture agreement receivable by the chargor;

(e) right, title and interest in joint venture product, proceeds of sale thereof, and accounts receivable arising from the sales contracts; and

(f) rights and benefits under any relevant sales contracts,

in favour of each of the other joint venturers.

Lenders will be vitally interested in the nature and enforceability of, and priority attaching to, such charges. Where cross-charges have been granted by the other joint venturers in favour of the borrower, the lender will wish to be satisfied as to their legal enforceability. However, such cross-charges can suffer from various infirmities, some of which are identified in the following discussion.

If the clause in the joint venture agreement constitutes an agreement to give a charge, then the agreement would constitute a charge and require registration as such if it was to be a valid security.[37]

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36 For example, in Queensland any agreement is void to the extent that it purports to relieve, or might have the effect of relieving, a mortgagee from the duty imposed by section 85 of the *Property Law Act* 1974 (Qld) to take reasonable care to ensure that the property is sold for its market value. Section 420A, *Corporations Law* also requires controllers exercising a power of sale to take reasonable care that the property is sold for its market value (if, when it is sold, it has a market value), or otherwise at the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold.

37 See the definition of "charge" in Section 9, *Corporations Law*.

Even if, as will usually be the case, the deed of cross-charge will be registered to perfect the security thereby constituted, it is not irrelevant that the joint venture agreement itself contains an unregistered (but registrable) charge over the same assets and property. Section 266(5) of the *Corporations Law* renders void as a security on the charged property, as against the liquidator of the chargor, a registrable charge which is created within 45 days of the creation of an unregistered registrable charge if the later charge relates to all or any of the property charged by, and is given as security for, all or any of the same liabilities as are secured by the earlier charge, even if notice in respect of the later charge is duly lodged.

The court may intervene to validate the later charge, if it is satisfied that the later charge was given in good faith for the purpose of correcting some material error in the earlier charge (which would be rarely applicable in this context), or "under other proper circumstances and not for the purposes of avoiding or evading the provisions of" the *Corporations Law*. The purpose of section 266(5) is to prevent a company from keeping a registrable charge off the public register of charges by the device of repeatedly re-granting the charge within the statutory registration period. While one would hope that a court would consider the creation of a later charge in performance of a condition of a joint venture agreement to execute a charge, as being given in good faith and under proper circumstances, it does nevertheless appear that the failure to register the agreement to give the cross-charge (if sufficiently unconditional and binding in its terms) would leave the later charge, even after due registration, susceptible to attack and requiring a favourable finding of the court to validate it. Dr W J Gough in his book, *Company Charges: An Australian Supplement*, expresses the view that a formal security pursuant to an earlier agreement should be an example where the court would hold that "other proper circumstances" applied.[38] This view is also expressed by E A Francis and K J Thomas, the authors of *Mortgages and Securities*.[39]

It is sobering to note, however, that the courts have at least on one occasion, exercised their discretion the other way.[40] This unenviable position can readily be avoided, of course, by the registration of both instruments as charges.

The cross-charge may also be void under section 266(1) of the *Corporations Law* as a security on the charged property, as against the liquidator of the chargor unless notice in respect of the charge was lodged within six months before the commencement of the winding-up or otherwise as required by the *Corporations Law*. If the chargor is or becomes insolvent, the cross-charge may in appropriate circumstances also be void under section 468 of the *Corporations Law* or void as against the liquidator of the chargor under section 120 as a voidable settlement or under section 122 (as a voidable preference) of the *Bankruptcy Act* 1966 (Cth) (which sections are incorporated in the case of corporate liquidations by section 565 of the *Corporations Law* in respect of transactions or conduct occurring before 23 June, 1993).

In addition, under section 566 of the *Corporations Law*, except in certain limited circumstances, a floating charge on the undertaking or property of a company created within six months before the commencement for the winding-up of the company is invalid unless it is shown that the company was solvent after the creation of the charge. For these purposes, a floating charge includes the "floating" component of a fixed and floating charge.

Part 5.7B of the *Corporations Law* now incorporates new provisions which apply where certain transactions or conduct occurred on or after 23 June, 1993. Preferential or uncommercial transactions on or after that date now attract new free-standing provisions, sections 588FA-FI, which deal with unfair preferences without the necessity to refer to the *Bankruptcy Act*. Floating charges created on or after 23 June, 1993 now fall for scrutiny under section 588FJ which will invalidate not only floating charges created within six months before the relation-back day (in the usual case, the

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38 (1983, Butterworths), at p 42.

39 3rd Edition, at p 200.

40 *Court as Liquidator of Versteeg Contractors Pty Ltd (In Liq) v Versteeg* (1986) 4 ACLC 650.

date of filing the application) but also those created up until the beginning of the winding-up (in the usual case, the making of the winding-up order).

If the courts were to hold a particular project joint venture to be in legal reality a partnership, it is worth noting that the High Court has held that a charge over a share in a partnership is a charge over "ascertained and definite" property in the shape of the chose in action (comprising the partner's share in the partnership consisting of a right to a proportion of the surplus after realisation of the assets and discharge of the liabilities of the partnership) and is, therefore, a fixed charge.[41] In that case, a charge over a share in a partnership was held to be fixed with the result that it was not void for want of registration under the *Companies Act* 1961 (Qld). However, this conclusion will only be reached where the charge is expressed to be over the chargor's interest in the partnership. If the charge is over all of the assets and undertaking of the company then the charge will be regarded as a floating charge in respect of the chargor's non-partnership assets and therefore must be registered in accordance with Part 3.5 of the *Corporations Law*.[42]

It should also be noted that the benefits of registration of charges (primarily, the priority protection afforded thereby) are available only in respect of charges over certain types of property, as set out in section 262(1) of the *Corporations Law*. Some of the assets the subject of cross-charges will fall outside the categories of property in respect of which a charge may be registered. Charges over those assets will not therefore be registrable unless they also relate to other property within the categories of property under section 262(1) over which a charge may be registered. If they do relate to other property within these categories, the benefits of registration apply to those charges only however to the extent that they relate to that other property.

Section 262(6) provides that a charge shall be taken to be a charge on property of the kind to which section 262(1) applies, notwithstanding that the instrument of charge also charges property of a kind to which section 262(1) does not apply. The *Companies Code* section equivalent to section 262(6) was considered in *Boambee Bay Resort Pty Ltd (in liq) v Equus Financial Services Ltd*[43] where the NSW Court of Appeal held that the assumption of section 262(6) is that a charge which includes both property that is within and property that is outside the categories set out in section 262(1) does not, by reason of its dual character alone, become registrable under section 262(1) in respect of both classes of property.

Sections 262(8) and 262(9) of the *Corporations Law* together have the effect that the provisions of the *Corporations Law* relating to registration and priority of charges do not apply to a charge on land or any fixtures attached to that land. The priority available upon registration of a charge under the *Corporations Law* does not therefore extend to charges over interests in land. It is important to note that section 262 of the *Corporations Law* only restricts the ability of a chargee to obtain priority for its charge by way of the registration procedure provided in that section. Nothing in section 262, however, operates to affect the validity of a charge created in respect of any type of asset, including land and fixtures. As a result, registration of a cross-charge under the *Corporations Law* will not be effective to ensure the priority of that charge in respect of the interest of the chargor in, for example, any mining tenement (in so far as they constitute an interest in land) or in respect of any freehold property or any other right or interest in land or fixtures on land acquired in connection with the joint venture.

Priority in relation to charges over interests in land may however be available under the registration system provided in other legislation (for example, by registration under the relevant State's Torrens System legislation). The joint venturer chargor may therefore be required to execute further security instruments for the purpose of obtaining this priority.

The *Corporations Law* also does not regulate, generally speaking, priorities between fixed securities over choses in action (except book debts). There also remains the difficulty of priorities as between

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41 *United Builders Pty Ltd v Mutual Acceptance Ltd* (1980) 33 ALR 1.

42 *Bailey v Manos Breeder Farms Pty Ltd* (1990) 3 ACSR 143.

43 (1992) 10 ACLC 56.

securities over agreements. A subsequent security holder or assignee may take priority if it is the first in time to give notice of its interest to the other party to the agreement.[44] The financier's lawyer should always therefore consider whether notice of the lenders' interests in any choses in action should be given to preserve the lenders' priority.

The question whether any charge is fixed or floating is not decided by the label put on it by the parties. A charge which the parties choose to describe as fixed will often nevertheless be treated as floating if it appears that they intended the joint venturer company to be able to continue its business in relation to assets the subject of the charge without reference to the chargee.[45] However, two recent English decisions afford greater weight to the fact that the parties have expressly set out to create a fixed charge.[46]

The English Court of Appeal in *Re New Bullas Trading Ltd* upheld the validity of a document under which a borrower created a fixed charge over uncollected book debts, on the basis that the proceeds of the collected debts were automatically released from the fixed charge and became subject to a floating charge.

The court made two critical findings:

- it is possible to create a fixed charge over present and future uncollected book debts, and
- uncollected book debts and their proceeds can be treated as separate assets for the purpose of creating a charge.

The Court of Appeal emphasised two factors in making the second finding:

- the parties' clear intention to subject book debts to a fixed charge while uncollected, and to a floating charge upon their realisation, and
- the parties' freedom to contract.

Courts in Australia have been unwilling to accept the creation of a fixed charge over the present and future book debts of a company in cases where the parties contemplate that the company will continue to do business.

Re Bullas Trading Ltd was recently considered by the Full Court of the Western Australian Supreme Court in *Mullins v The Queen.* The court had to decide whether a charge over uncollected book debts was fixed or floating. The charge document stated that the charge over book debts was fixed but gave the borrower freedom to deal with proceeds in the ordinary course of its business.

The court noted that, unlike in *Re New Bullas Trading Ltd*, the document was not clearly drafted to convert a fixed charge into a floating charge once the book debts were collected. The court therefore refused to treat uncollected book debts and their proceeds as separate assets. It concluded that the borrower's freedom to deal with the proceeds meant that the "fixed" charge over uncollected book debts was, in law, a floating charge. Nevertheless, the court recognised the possibility of a properly drawn document creating a fixed charge over uncollected book debts, even if it gives the borrower freedom to deal with proceeds. What seems to be required is a clear intention in the charge that uncollected book debts and their proceeds are to be treated as separate assets.

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44 Pursuant to the rule in *Dearle v Hall* (1828) 38 ER 475.

45 *Mullins v The Queen* (unreported, Full Court, Supreme Court of Western Australia, Kennedy, Nicholson and Ipp JJ, No 67 of 1994); *Perrins v State Bank of Victoria* (1991) IVR 749.

46 *Re New Bullas Trading Ltd* (1994) Times, 12 January (Court of Appeal: Nourse and Russell LJJ and Scott Baker J); *Re Cimex Tissues Ltd* (1994) BCC 626.

Where the cross-charge relates to personal property situated in Queensland (for example, plant and equipment forming part of joint venture property) it is likely that the instrument will need to be registered as a bill of sale in Queensland (in addition to registration under the *Corporations Law*) and also that it will have to satisfy the mandatory requirements as to the form and content of instruments under the *Bill of Sale and Other Instruments Act* 1955 (Qld). Failure to satisfy these requirements will render the charge void as against third parties in relation to the property comprised in the charge.[47]

Lenders have generally accepted that the claim by non-defaulting joint venturers against a defaulting joint venturer to payment of its proportionate share of the expenses and liabilities of the joint venture should enjoy a priority, as regards the joint venturers' joint venture interest and, frequently, its entitlement to product and the proceeds of sale of its product as well, over the claim of a lender under a security over those assets. Lenders therefore frequently consent to each joint venturer executing in favour of the others a deed of cross-charge and will also permit the cross charges to rank in priority, provided:

(a) the minimum sale price for the defaulter's interest is reasonable;

(b) enforcement by the non-defaulting joint venturers (by appointing receivers, taking possession, exercising power of sale or otherwise) is delayed for a reasonable period after notice to the lenders to enable the lenders, if they so elect, to remedy the default or to exercise their default powers in priority;

(c) the obligations secured by the cross charge are limited to joint venture obligations (but only those joint venture obligations under contemplation at the time the financing was approved; query also the position of a large uninsured claim by a third party against the joint venturers for environmental damage - the lenders may be most unhappy to find themselves postponed in this situation);

(d) the extent of priority to be afforded to the cross chargee is agreed;

(e) the cross charge is limited to the joint venturer's interest in the joint venture;

(f) there is no obligation on the financiers to meet the borrower's liability for calls if they enforce their security.

Joint venture agreements usually permit a venturer to charge its joint venture interest in favour of external financiers provided the financiers enter into an appropriate priority agreement with the other joint venturers in an agreed form. Apart from specifying the agreed priorities, this agreement may also oblige the financier to observe certain provisions of the joint venture agreement when enforcing its security: for example, those restricting the assignment of joint venture interests.

Completion covenants

In addition to the usual bank guarantees, performance bonds and retention sums normally provided under construction contracts, lenders would wish to be satisfied that the joint venture agreement incorporated a well drafted completion covenant whereby the joint venturers covenanted inter se to complete the project. This is particularly important because, as already observed, in a several financing the borrowing joint venturer will not usually be able itself to give the lender a satisfactory completion covenant.

Financiers will be vitally interested to ascertain what constitutes "completion" for these purposes, and the financiers should insist that any completion covenant extends expressly in favour of the financier, as well as the borrower. Execution of an additional "completion guarantee", to which the financier is a party, may be necessary. If any of the joint venturers are insubstantial, it may also be necessary for a

47 *Re Bauer Securities Pty Limited* (1990) 8, ACLC 230 (upheld by the Full Court of the Supreme Court of Queensland in *Austral Mining Construction Pty Limited v NZI Capital Corporation* (1991) 4 ACSR 57).

parent company to guarantee the completion covenant of its subsidiary. Financiers should be made aware of the practical difficulties associated with the enforcement of completion guarantees. In this context, it is important to distinguish between two types of "completion guarantee". The first type is an undertaking to ensure that completion of the joint venture project occurs by a specified date. The main disadvantage of this type of completion guarantee is actually ascertaining the consequences of a breach. In the absence of express provisions, the institution of a lengthy and uncertain claim for unliquidated damages may be the only available remedy, with the prospect of some potentially difficult arguments concerning causation and quantum of loss.

The second and preferable type of completion guarantee is a financial guarantee of the debt which continues in force until completion of the project. The lenders' only concern is then to ensure that the definition of "completion" is both rigorous and unambiguous.

Disclosure of information and confidentiality

It is obviously important that the joint venture agreement permit a borrowing joint venturer to provide information to its lenders and potential lenders. In particular, the borrower will wish to provide copies of all relevant agreements, documents, technical and financial information. The other joint venturers may require the lenders to covenant to treat this information and documentation confidentially.

The lenders will also wish to be permitted to disclose this confidential information in an enforcement situation.

Consequences of enforcement of lender's securities

The lenders will wish to assess whether default or termination powers of non-defaulting joint venturers are triggered upon enforcement of the lenders' securities.

Fiduciary duties

The extent to which fiduciary obligations exist between joint venturers is of considerable concern in the situation where the financier is or is to become a participant. Many joint venture financings have utilised structures where the financier has taken an equity participation in the project. In this context, *United Dominions Corporation Ltd v Brian Pty Ltd*[48] confirms that a financier who becomes a partner must accept the liabilities flowing from that role and cannot use its position as financier to alter that role. Similarly, a financier who becomes a non-partner joint venturer must accept the obligations arising from the joint venture relationship, which may include fiduciary obligations owed to the other participants.[49] Whether fiduciary relations exist between joint venturers will depend largely on the terms of the joint venture agreement and the circumstances of each case.[50]

Despite an earlier reluctance to impose fiduciary obligations in a commercial context,[51] the reasoning of the various members of the High Court in *United Dominions Corporation Ltd v Brian Pty Ltd*[52] indicates that fiduciary obligations are not confined, in the commercial context, to relationships

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48 (1985) 157 CLR 1.

49 For recent examples, see *Crusader Resources NL v Santos Ltd* (unreported, South Australian Supreme Court (FC), 18 June 1991) and *Pacific Coal Pty Ltd v Idemitsu Queensland Pty Ltd* (unreported, Queensland Supreme Court, 21 February 1992, Ryan J).

50 For example, the circumstances of *Pacific Coal Pty Ltd v Idemitsu Queensland Pty Ltd* (supra) were such that the court found that there was a fiduciary relationship between co-venturers. However, after reviewing the relevant circumstances in another case, the Federal Court held in *Diversified Mineral Resources NL v CRA Exploration Pty Ltd* (unreported, Federal Court, Sydney, Whitlam J, 3 February 1995) that there was no fiduciary relationship.

51 *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41.

52 (1985) 157 CLR 1.

classified as partnerships. Where the relationship falls outside that classification, the court examines the joint venture agreement and structure to determine the actual obligations undertaken by the parties. In light of *United Dominions Corporation Ltd v Brian Pty Ltd*,[53] the following additional matters should also be taken into consideration.

First, parties who enter into negotiations for a joint venture agreement should be aware of the duty which prospective joint venturers may owe to each other. Fiduciary obligations can arise even in pre-contractual negotiations. Relevantly, joint venturers must not mislead each other and must positively make full disclosure. Also joint venturers are accountable for secret profits made without their joint venturer's knowledge and consent, and also for profits made as a result of information gained in the course of the joint venture business.

Secondly, full disclosure by one joint venturer and express consent by the others usually prevents the disclosing party from incurring liability for breach of any fiduciary duties owed. Thirdly, whether a joint venturer attracts fiduciary obligations depends on the form and content of the joint venture agreement. If there is a de-emphasis of any relationship based on trust and confidence and a stressing of the contractual relationship (that is, the commercial and arm's length nature of the arrangement), fiduciary duties and obligations may be negated.

Noranda Australia Limited v Lachlan Resources NL[54] and, more recently, *Diversified Mineral Resources NL v CRA Exploration Pty Ltd*[55] have suggested that joint venturers in an unincorporated joint venture can limit the extent of their fiduciary obligations by carefully drafted express terms to that effect in the joint venture agreement.

Where the financier is not a member of the joint venture, it will be shielded to a certain extent from breaches of fiduciary duty occurring between co-venturers. In *Bosnjak v Farrow Mortgage Services Pty Ltd (in liq)*[56] a joint venturer induced co-venturers to personally guarantee the joint venture's borrowings by misleading the co-venturers in relation to the likely success of the project. One of the co-venturers sought to have the guarantee set aside on the basis of these misrepresentations. The court rejected the application and held that if a joint venturer is misled by a co-venturer, the financier should not be required to bear the consequences.

Rights of pre-emption

Lenders will need to consider whether any rights of pre-emption contained in the joint venture agreement contravene the common law rule against perpetuities or any statutory glosses on those rules contained in legislation of the relevant State or Territory. There is considerable doubt whether the common law rule against perpetuities will apply in respect of pre-emptive rights under most joint venture agreements. The scope and content of the rule against perpetuities differs however in each State and Territory depending on whether the common law rules apply or whether the common law has been replaced or varied by statutes in each case. In Queensland, for example, section 218 of the *Property Law Act* 1974 provides that an option to acquire an interest in land or a right of pre-emption in respect of land, which according to its terms is or may be exercisable at a date more than 21 years from the date of grant, shall after the expiration of 21 years from the date of grant, be void, unless the

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53 Ibid.

54 (1988) 14 NSWLR 1.

55 (Unreported, Federal Court, Sydney, Whitlam J, 3 February 1995, QG163 of 1990). See also *Mount Isa Mines Ltd v Seltrust Mining Corporation Ltd* (unreported, Supreme Court of Western Australia, 5 July, 1985; Court of Appeal, 27 September, 1985); *Kelly v Bell Commodities Corporation Ltd* (1990) 18 NSWLR 248.

56 (1993) ASC 56-225.

option for renewal or right of pre-emption is contained in a lease, agreement for lease or is conferred by will.[57]

Proper law

Lenders will need to investigate whether there has been an appropriate choice of proper law. Under English and Australian law, there is considerable freedom to expressly choose any system of law to govern a contract. The precise limit of freedom is unclear but some have postulated that the test appears to be that of any reasonable justification for the choice, which may include the desire of the parties to subject the transaction to a neutral or familiar system.[58] It has also been held that parties are not permitted to abuse this freedom of choice by selecting a proper law which validates a transaction which would have been void or illegal under the legal system which would otherwise have applied.[59] It is important for the financier to bear in mind that the proper law chosen is that law as it exists from time to time.[60]

Whatever proper law is chosen, financiers will need to check to ensure that the joint venture agreement has been executed in a way that would bind each of the parties in accordance with the law of that party's country. Under English and Australian law, questions of the status and powers of a party are usually determined by the law of the place of incorporation of that party.[61]

Immunity from suit provisions

The lender will need to consider whether the joint venture agreement contains, or should contain, an immunity from suit provision. Such a provision usually provides that to the extent that any of the parties to the joint venture agreement has or subsequently acquires any immunity from the jurisdiction of any court or from any legal process with respect to itself or its property, each of the parties irrevocably waives that immunity in respect of its obligations under the joint venture agreement or otherwise in relation to the joint venture.

Such a provision is of particular relevance where a sovereign State (or an instrumentality or corporation controlled by a sovereign State) is a party to the joint venture agreement. Many of the difficulties resulting from the common law doctrine of sovereign immunity have been overcome in Australia by the *Foreign States Immunities Act* 1985 (Cth). The provisions of that legislation should be considered (and its requirements specifically addressed) if any party is likely to be in a position to be able to claim sovereign immunity in relation to either itself or its assets.

In this context, consideration should also be given to the *ICSID Implementation Act* 1990 (Cth) which gives effect in Australia to the Washington Convention of the Settlement of Investment Disputes between States and Nationals of Other States (which with effect from 1 July, 1991 has been ratified by and is enforceable against Australian parties which can claim sovereign immunity). The International Centre for the Settlement of International Disputes ("ICSID") was established under the aegis of the International Bank for Reconstruction and Development (commonly known as the "World Bank"). ICSID, as a new arbitral centre, was designed as a completely impartial venue for the resolution of disputes unconnected to and uninfluenced by the courts of either party to the investment. The only nexus with domestic courts was, of necessity, to be in the enforcement of awards. The ICSID Convention, which provides an autonomous regime for the conciliation and

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57 For a general discussion of the rule against perpetuities in the joint venture context, see P J Allen and R I Cottee, "The Effect of the Rule Against Perpetuities on Pre-emptive Rights in Joint Ventures", 1982 *AMPLA Yearbook* 190 and Kevin McCann, "Pre-emptive Rights in Resource Joint Venture Agreements" (1990) *AMPLA Yearbook* 445.

58 See, for example, *Vita Food Products Inc v Unus Shipping Co Ltd* (1939) AC 277 at 291.

59 See, for example, *Golden Acres Ltd v Queensland Estates Ltd* (1969) QdR 378.

60 *Re Helbert Wagg & Co Ltd* (1956) Ch 323.

61 *Carl Zeiss Stiftung v Rayner & Keeler Ltd (No 2)* [1967] 1 AC 853 at 919 per Lord Reid; see also *P T Ltd v Maradona Pty Ltd* (1992) 25 NSWLR 643 at 655 per Giles J; this is also confirmed by sections 7(2) and (3) of the *Foreign Corporations (Applications of Laws) Act* 1989 (Cth).

arbitration of investment disputes between host States and foreign investors, will not apply unless the host State and foreign investor have agreed to submit the particular dispute arising out of an investment to ICSID.

Power of attorney provisions

Many joint venture agreements will incorporate power of attorney provisions. Where the joint venturer is appointed manager to carry out the various functions specified in the joint venture agreement, it is not uncommon for the joint venturers to each appoint the manager and its various officers jointly and severally as their attorney for the purposes of doing all acts and executing all documents as may be necessary for the due performance by the manager of its obligations under the agreement, or to perfect any transfer of joint venture property pursuant to the joint venture agreement. A financier will wish to ascertain whether the power of attorney provisions in the joint venture agreement are likely to be appropriate, particularly in a default situation.

It is desirable for a power of attorney to be executed under seal, so that the attorney will itself be able to execute deeds.[62] If the joint venture agreement has not been executed as a deed, it may be necessary to execute a separate deed conferring the powers. The powers of attorney should be stated to be irrevocable. Most States' property law legislation provides that where a power of attorney which is expressed to be irrevocable and is granted to secure a proprietary interest of the attorney under the power of attorney or the performance of an obligation owed to the attorney, then so long as the attorney has the secured interest or the secured obligation remains undischarged, the power of attorney shall not be revoked by the donor without the consent of the attorney or by the death or incapacity or bankruptcy of the donor or, if the donor is a body corporate, by its winding-up or dissolution.

The corresponding legislation dealing with powers of attorney in each relevant State should be checked carefully to ensure that the relevant provision satisfies the statutory language. Even if it does not, the common law continues to be of residual relevance. Provided the power of attorney is given for consideration and is granted to secure some benefit to the donee, the courts may still regard the power of attorney as irrevocable by the donor without the donee's consent and unaffected by the donor's insolvency, while the interest of the donee subsists.[63]

Conditions precedent to joint venture commencement

The lender will need to determine whether any conditions precedent to the operation of the joint venture agreement have been satisfied, or if not satisfied, are clearly expressed so as to avoid the risk that the condition is too uncertain to be legally enforceable in which case the joint venture agreement as a whole may be avoided by a court.[64]

Foreign participation

Where any seemingly foreign persons or corporations are parties to the joint venture agreement, the lender should check whether all necessary approvals under Australia's Foreign Investment Policy and under the *Foreign Acquisitions and Takeovers Act* 1975 (Cth.) have been obtained. Even where necessary approvals have been obtained, it will still be necessary to check that any conditions attaching to that approval have been satisfied. A failure to comply with any conditions constitutes an

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62 See *Powell v London & Provincial Bank* (1893) 2 Ch 555 at 563.

63 *Frith v Frith* [1906] AC 254; *Barclays Bank Ltd v Bird* [1954] Ch 274; *Slatter v Railway Commissioners for New South Wales* (1931) 45 CLR 68.

64 See, for example, *Meehan v Jones* (1981-82) 149 CLR 571.

offence punishable by fines and/or imprisonment, and upon conviction the Treasurer can order divestiture.[65]

Exclusion of indicia of partnership

For the reasons identified previously, the lender should also check whether the joint venture agreement clearly specifies that the relationship of the parties shall be one of joint venturers, and not of partners. Such a clause does not of itself necessarily avoid a partnership relationship if the other indicia of partnership are present.[66] To avoid any suggestion of partnership, the joint venture agreement would normally need to:

(a) provide for separate ownership and disclosure of assets or product of the joint venture activity;

(b) provide the joint venture assets are to be owned by the venturers in specified shares, as tenants in common;

(c) disavow mutual agency between the joint venturers; and

(d) for what it is worth, incorporate a provision confirming that a partnership is not intended. A mere disclaimer of partnership will be of no avail if the association is in fact properly characterised as a partnership.

6. THE POTENTIAL APPLICATION OF PART 3.2A OF THE CORPORATIONS LAW

The *Corporate Law Reform Act* 1992 introduced a new Part 3.2A, which replaced section 234 of the *Corporations Law.*

In contrast with previous regulation under section 234 of the *Corporations Law*, Part 3.2A applies only to transactions between public companies and their related parties rather than to all companies, both public and proprietary. The new scheme introduced by Part 3.2A prohibits the giving of any financial benefit to a related party of a public company by the public company or a child entity of the public company (which is defined to include a subsidiary of, or other entity controlled by, the public company) unless:

(a) the financial benefit falls within one of the limited exceptions to Part 3.2A; or

(b) the financial benefit has been approved by a majority of disinterested shareholders who have been fully informed regarding the cost and consequences of the proposed financial benefit.

One of the principal areas of concern for financiers is how the related party provisions will affect them when they deal with public companies, child entities and their related parties. The main prohibitions in Part 3.2A should not often apply directly to financiers, because they will generally not themselves be related parties of the public company.

However, there will be circumstances in a joint venture financing context where a financier may be involved in a transaction which contravenes the related party provisions. Guarantees and third party securities constitute "financial benefits" for the purposes of Part 3.2A. Therefore, where a financier is to lend money to a parent of a public company, and the public company is to provide a guarantee or give security over its assets for the loan, the prohibitions in Part 3.2A are of potential application unless one of the exceptions applies or shareholder approval is obtained. The definition of "giving a financial benefit" provided by section 243G of the *Corporations Law* is so wide as to render Part 3.2A

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65 Section 25(1C) of the *Foreign Acquisitions & Takeovers Act* 1975 (Cth).

66 *Adam v Newbigging* (1988) App Cas 308 at 315; *Stekel v Ellice* (1973) 1 WLR 191 at 199; *Ex parte Coral Investments Pty Ltd* [1979] QdR 292.

of potential application to any transaction between a related party of a public company and either the relevant public company or one of its child entities.

From a financier's point of view, it is important to recognise that Part 3.2A will not only be relevant where the financier is to be the beneficiary of a guarantee or other third party security or is otherwise involved in a transaction. Part 3.2A will also be of potential application to contracts or arrangements which a financier may view as material to any credit being considered by it. Furthermore, financiers can often be inadvertently involved in the "giving of a financial benefit" in structured finance transactions, or when they are arranging the financing of the transaction.

Although not limited to this situation, Part 3.2A may be of particular concern to financiers considering a joint venture financing, where there may be a number of material contracts under which "financial benefits" are, or may be, provided to a related party of a public company, either by the public company itself or one of its child entities. Such contracts could include significant supply, service or sales contracts which are vital to the operation, cashflow and/or overall profitability of the project.

It would undoubtedly be of concern to potential financiers to ascertain that their borrower, or any security provider, is required to account for profits accruing to it, or losses suffered by others, in connection with a transaction entered into in breach of Part 3.2A.

At a practical level, it may be necessary for financiers and others to review every proposed transaction between parties which are unrelated but belong to corporate groups to ascertain whether there is any linkage higher up in the corporate chain which might create a "related party" relationship and an indirect benefit sufficient to attract the general prohibition in section 243H. Regrettably, it will not be enough to assess the relationship between the parties directly concerned in the transaction.

7. ARE THERE ANY STATUTORY OR OTHER RESTRICTIONS AND PROHIBITIONS AFFECTING THE JOINT VENTURERS?

Financiers will also need to enquire whether there are any relevant statutory or other restrictions, prohibitions or limitations which affect the joint venturers. These will vary from project to project and often depend upon the identity of the joint venturers. Examples include:

7.1 Section 16 of the *Banking Act* 1959 (Cth)

Where the financier is a bank regulated by the *Banking Act* 1959 (Cth) and the financier wishes to take an equity position in the joint venture, the implications of section 16 of the *Banking Act* 1959 (Cth) must be considered. Section 16 provides that in the event of a liquidation, the assets of a bank must be made available first to its depositors in priority to all other liabilities of the bank. Therefore, in the case of leveraged lease financings, banks assuming the role of equity participants usually come together in the form of a partnership and a trustee holds the title to the leveraged lease equipment on behalf of the banks. It is claimed that the mortgaging of the leveraged lease equipment or the interest in the leveraged lease itself by the trustee in favour of the lenders/debt participants, is not a mortgaging thereof by any one partner with the result that the partner/bank is not placing itself in a position where it could be in breach of section 16 of the *Banking Act* 1959 (Cth).

7.2 Section 38(3) of the *Life Insurance Act* 1945 (Cth)

Where a life insurance company is involved in the joint venture, the potential restrictions imposed by, for example, section 38(3) of the *Life Insurance Act* 1945 (Cth) must not be overlooked. Section 38(3) prevents any life insurance company from mortgaging or charging any of the assets of any statutory fund, which it is obliged to establish, otherwise than to secure a bank overdraft. However, it is proposed that this restriction will be loosened when the *Life Insurance Act* 1995 becomes operative. Section 40 of the new legislation contemplates that a life company may also mortgage or charge an asset of a statutory fund, if the security is to be given in connection with the undertaking of a major development project and the Insurance and Superannuation Commissioner and the Treasurer have consented.

7.3 Ultra vires challenge

Where a local authority, statutory corporation or other such instrumentality is involved in the joint venture financing arrangements, it is necessary to enquire whether the proposed transaction might be susceptible to challenge on the basis of ultra vires, as occurred in *Hazell v Hammersmith and Fulham London Borough Council.*[67]

7.4 Superannuation fund trustees

Where a trustee of a regulated superannuation fund is involved, the restrictive rules under the *Superannuation Industry (Supervision) Act* 1993, which regulate the circumstances in which, and the limited extent to which, trustees of regulated superannuation funds may invest funds, borrow money, charge fund assets, lend money or provide financial assistance to members and their relatives, must be considered.

7.5 Foreign joint venturers

Where foreign joint venturers are involved, domestic tax considerations must be taken into account (for example, the thin capitalisation rules within Division 16F of Part 3 of the *Income Tax Assessment Act* 1936 (Cth); interest and dividend withholding tax ramifications; the availability of foreign tax credits) before determining the most appropriate form of joint venture financing. The necessity to obtain approval under the *Foreign Acquisitions and Takeovers Act* 1975 (Cth) and the Australian Government's foreign investment policy also falls for consideration.

7.6 State Government related borrowers and Loan Council requirements

Where State Government related borrowers are involved, lenders need to be satisfied that the Loan Council arrangements and guidelines between the Commonwealth and State Governments (which regulate and monitor the borrowing transactions entered into by the States) will not be breached.

The constitutional basis for the Loan Council is section 105A of the *Commonwealth Constitution* which was inserted following a successful referendum in 1928. In essence, this section empowers the Commonwealth to make agreements with the States in respect of the public debts of the States.

The Loan Council was established pursuant to the Financial Agreement signed on behalf of all State Governments and the Commonwealth Government in 1927. The Financial Agreement itself is not a law of the Commonwealth, but merely a contract imposing obligations on the Commonwealth and the States.

The history of the matter is that before 1927 the public debt and accruing interest had swollen, especially since World War 1, out of all proportion to incoming revenue. At that time, the Commonwealth and the States borrowed independently, as any sovereign government does. This meant that they vied with one another in offering competitive interest rates to investors. The Commonwealth-State Financial Agreement of 1927 ended this self-destroying rivalry and established the Australian Loan Council. Thereafter most of the public borrowing in Australia could be undertaken only with the approval of the Loan Council. Initially the Loan Council determined the amount of borrowings by each State and the conditions which attached to those borrowings. Each State Government submitted the total of its borrowing programme to the Loan Council each year. The total would then be approved by the Loan Council and borrowed by the Commonwealth on behalf of all

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67 [1991] 2 WLR 372.

State Governments. The 1927 Financial Agreement was restricted only to State Government borrowings. In 1936 an agreement between the States and the Commonwealth called the "Gentlemen's Agreement", extended the Loan Council's jurisdiction to borrowings by semi-government and local government authorities.

Over the years, it was found that State Governments had exploited the loose drafting of the agreement by:

(a) obtaining financial accommodation which was outside the definition of "borrowings" in the Financial Agreement (eg operating leases); and

(b) obtaining borrowings through semi-government authorities which were outside the umbrella of the Loan Council.

The Financial Agreement seems to have ended in June, 1985, for its substantive clauses were expressed to run for only 58 years. In 1985, a new "global approach" to borrowing was adopted. Under this method the Commonwealth determined a global limit for all borrowings by all State Governments and their authorities and then allocated proportions of that limit to the various States. However, by the end of 1992 it was acknowledged that the global limits method was also at the point of breakdown and required a major overhaul.[68]

In December 1992 the Loan Council adopted new arrangements for the reporting and monitoring of public sector borrowings. Under the new arrangements, the focus was switched from the gross borrowings of each State to an aggregate based on net borrowings. In this context, net borrowings is based upon the deficit or surplus of the State in question.

Under the new arrangements the Commonwealth and each State and Territory nominates to the Loan Council its intended allocation for financing requirements, known as the Loan Council Allocation ("LCA"). The LCA is based on the deficit or surplus of the relevant jurisdiction plus a number of adjusting items called "memo items". These memo items take into account matters which would not have been regarded as borrowings under the previous regime such as operating leases and transactions utilising public sector superannuation funds. The Loan Council then considers the appropriateness of the nominated LCA having regard to:

(a) the macro-economic policy objectives of the Commonwealth; and

(b) the fiscal outlook for the relevant jurisdiction.

The LCA will provide a clear indication to financial markets, the public and credit rating agencies of the relative financial position of each State. Under the new arrangements there is a shift away from control upon borrowings by the Commonwealth and an increasing emphasis on each State and Territory being responsible for its own borrowings. The new arrangements involving LCAs are designed to facilitate greater scrutiny by financial markets and allow for decisions by those markets to be the principal discipline in respect of loans taken out by the various States.

The primary sanction applied by the Commonwealth to the States for failing to comply with Loan Council guidelines appears to be the prospect of a reduction in the grants provided by the Commonwealth to the States each year. In *Sankey v Whitlam*[69] the High Court considered whether criminal penalties applied to breaches of Loan Council requirements. In that case, the Whitlam Government entered into negotiations for loans which had not been approved by the Loan Council. A private individual subsequently brought an action against Ministers of the Whitlam Government alleging a conspiracy to effect an unlawful purpose under a law of the Commonwealth within the terms of section 86(1)(c) of the *Crimes Act* (Cth). However, the High Court held that the Financial

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68 The Loan Council "Future Arrangements for Loan Council Monitoring and Reporting", 5 July 1993, page 1.

69 (1978) 142 CLR 1.

Agreement was not a law of the Commonwealth and therefore was outside the scope of section 86 of the *Crimes Act*. Instead, the High Court categorised the Financial Agreement not as a statutory instrument but as an agreement which only created contractual rights between the Commonwealth and the States.

It should be noted that the Loan Council has recently adopted new guidelines for assessing private sector involvement in public infrastructure projects. These guidelines adopt a risk-weighting methodology for borrowings related to private sector involvement in infrastructure projects. The objective of these guidelines is to ensure that Loan Council classification is a neutral consideration in government decisions on whether to involve the private sector in infrastructure projects.[70]

7.7 Local authorities

Where one of the joint venturers is a local authority, the lender should enquire whether the local authority has complied with the relevant statutory requirements relating to participation in joint ventures and other commercial enterprises.[71] These requirements can limit the amount which a local authority can contribute to the venture,[72] the form of the joint venture[73] and the liability of the local authority under the joint venture agreement.[74] Significantly, the Queensland *Local Government Act* 1993 prohibits a local authority from borrowing or providing a guarantee in connection with a joint venture.[75]

8. LIMITING THE FINANCIERS' EXPOSURE

There are various steps which financiers can implement to further limit their exposure when advancing funds to a joint venturer borrower. Some of those steps include the following:

8.1 Feasibility studies and due diligence

The joint venturers, contractors and other key parties will usually conduct extensive feasibility studies investigating all aspects of the joint venture project before the joint venturers commit to it. The lenders should call for and carefully assess copies of these studies.

In addition, the lenders will normally retain their own experts to confirm all aspects of the transaction. The lenders' due diligence enquiries can extend to all engineering aspects of the project, major equipment reliability and warranties, the accuracy of financial models and taxation assumptions, the acceptability and enforceability of key contracts, adequacy of insurances, compliance with laws (including environmental laws) and confirmation that all necessary authorisations and approvals have been obtained.

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70 Dawkins, John, "New Guidelines for Loan Council - Coverage for Infrastructure", Press Release No 128, 12 October 1993; cf Furnell, C, "Infrastructure Projects - Loan Council Implications", *Journal of Banking and Finance Law and Practice*, Vol 5 No 4, December 1994, page 293.

71 See, for example, Part 4, Chapter 6 of *Local Government Act*, 1993 (Qld); sections 4750 to 475Q *Local Government Act*, 1919 (NSW); sections 193 and 194 *Local Government Act*, 1989 (Vic); sections 196 and 197 *Local Government Act*, 1934 (SA).

72 Section 413(a) *Local Government Act*, 1993 (Qld).

73 Sections 413(c) and (d) *Local Government Act*, 1993 Qld.

74 Section 413(e) *Local Government Act*, 1993 (Qld).

75 Section 413(b) *Local Government Act*, 1993 (Qld).

8.2 Provision for contingencies

Both the lenders and the joint venturers will be concerned about the effects of events of *force majeure*. The possible disruption caused by events of *force majeure* are sometimes resolved through limited extensions of the date for completion. From the lenders' perspective, one way of mitigating the completion risk exposure is to include appropriate contingency allowances in the debt funding facilities to cover cost overruns, interest rate blowouts and other delays. Lenders should always bear in mind that it is also important to tie force majeure extensions under the construction or completion agreements to extensions which are available under other critical project documents.

8.3 Completion and liquidated damages

Another way for lenders to deal with the risk that completion of the project may not occur by a specified date would be to insist that the following obligations are imposed on the relevant contractors under construction contracts entered into in respect of the project:

(i) liquidated damages in the amount of the debt service shortfall will be payable commencing on a specified date after the anticipated completion date for the project. If properly drafted, such provisions should be enforceable and should not be construed as penalties. Clauses imposing substantial liquidated damages calculated by reference to holding costs have recently been construed by the courts as valid;[76]

(ii) additional liquidated damages will be payable commencing on a later date in the case where physical completion has occurred but the constructed facility does not meet warranted performance levels. The additional liquidated damages will reflect an amount intended to partly repay a portion of the debt. The payment will be designed to preserve the originally anticipated level of debt service coverages while reflecting the lower performance levels (and hence, revenue) achievable due to the performance warranties not being met.

It should be noted that many contractors are not prepared to assume unlimited liability for consequential loss, in which event the lenders must look to a creditworthy provider of an appropriate completion guarantee.

8.4 Completion guarantees

As foreshadowed previously, lenders should consider insisting on appropriate completion guarantees by the borrower or its parent, in addition to the bank guarantees, performance bonds and retention sums normally provided under construction contracts entered into in respect of the joint venture project.

8.5 Insurance

To accommodate *force majeure* and other risks, the lenders will need to consider the necessity of appropriate insurance, including business interruption and environmental risk insurance. Insurance should not be regarded as a complete panacea for the potential delays in paying claims and the possibility of exclusions applying require careful due diligence concerning the identity of the insurers and the terms of the relevant policies. It will of course be important for the financiers to be named as co-insureds and for the insurers to agree not to cancel policies without reasonable prior notice to the financiers.

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76 *Multiplex Constructions Pty Ltd v Abgarus Pty Ltd* (1992) 33 NSWLR 504.

8.6 Equity

From the lenders' perspective, a minimum level of equity will be required to ensure a buffer against day to day risks and adequate debt service cover ratios.

A substantial equity investment is also desirable to give the lenders comfort that the joint venturers have a substantial stake in ensuring that the project will be a success.

8.7 Disclaimer provisions

Where the lenders propose to take an equity position in the project, they will need to bear in mind that all parties involved may be exposed to the risk of action against them for breach of contract, negligence and misleading conduct. Some of this risk can be mitigated to a certain extent by appropriate provisions in the relevant documents which limit or quantify a liability; for example, liquidated damages clauses can fix the liability for breach of contract to which they relate. Financiers should also remember that liability for negligence and consequential loss must normally be expressly excluded. However, it is not possible to contract out of liability for misleading or deceptive conduct under section 52 of the *Trade Practices Act* 1974 (Cth).