



HM TREASURY

Joint Ventures:

a guidance note for public sector bodies
forming joint ventures with the private sector

March 2010



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Preface

This document replaces the previous Guidance Note for Public Sector Bodies forming Joint Venture Companies with the Private Sector, issued in December 2001.

In line with HM Treasury's approach, as set out in "Infrastructure procurement: delivering long-term value" (March 2008), this Guidance looks at the issues associated with the creation and use of Joint Venture entities across the wider procurement spectrum. This is a change from the previous Guidance Note which concentrated on the creation of corporate Joint Ventures for creating value under the Wider Markets Initiative. This revision includes guidance on issues associated with the creation of a wider range of Joint Venture entities, in particular companies, limited partnerships and limited liability partnerships.

This Guidance Note is not a replacement for independent specialist advice and those who use it should ensure that they take appropriate legal, financial and technical advice. HM Treasury and its advisers accept no liability whatsoever for any expense, liability, loss, claim or proceedings arising from reliance placed upon this Guidance Note or any part of it. Users must always satisfy themselves as to the applicability of the relevant part(s) of this Guidance Note to the particulars of their project.

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1

Introduction

This Guidance outlines issues for public sector bodies forming Joint Ventures (“JVs”) with the private sector. The Guidance concentrates on the factors which the public sector should consider in determining whether a JV is the best delivery model for its infrastructure and public services needs and one which will meet its objectives in the most effective and efficient way. It explains key issues that need to be addressed in establishing or procuring a JV arrangement and provides a framework for the public sector body to follow.

This Chapter sets out:

- The purpose and scope of the Guidance;
- What is meant by a “Joint Venture” in the context of this Guidance;
- When a JV might be appropriate; and
- The key steps in setting up a JV.

Purpose and scope

1.1 The Government’s approach to the procurement of complex public infrastructure through Public Private Partnerships is described in HM Treasury’s publication “Infrastructure procurement: delivering long-term value”. The publication sets out a range of approaches which have been developed to address the diverse needs of different public sector bodies. Going forward the Government expects that a number of different delivery models may be used by public bodies to deliver infrastructure and public services in conjunction with the private sector. For the purpose of this Guidance references to the private sector include not-for-profit and third sector providers.

1.2 This Guidance is focused on one of those models, namely Joint Ventures (JVs) where both a public sector body and the private sector contribute to a commercial venture and agree to develop and manage that business on a joint basis. As such contractual JVs, public to public JVs and not-for-profit structures are not covered in detail in the Guidance other than for reference and comparison purposes, however, many of the principles and issues set out in this Guidance would still apply to them.

1.3 Many of the issues set out in this Guidance are complex and public sector bodies should ensure they have professional legal and financial advice when setting up a JV. Some public sector bodies will need to seek further advice from other relevant organisations, e.g., issues surrounding statutory powers, classification and financial reporting of local authority JV companies should be raised with Local Partnerships (previously 4ps) or the Department of Communities and Local Government (CLG). Separate guidance is also available from the Department of Health (DOH)¹.

1.4 Given the range of possible applications and JV structures, this Guidance does not attempt to describe one “best” way to form a JV nor does it seek to identify all the issues which may arise. Rather, it aims to provide guidance and assistance in considering the setting up of a JV, a

¹ Department of Health Transaction Manual, February 2009.

framework in which to develop and negotiate a JV and an explanation of key issues which frequently arise.

1.5 This Guidance is structured around the key steps for setting up a JV and as the issues discussed become progressively more technical and complex, accordingly the target audience is expected to become increasingly specialised towards the later Chapters.

1.6 This Guidance is not intended as a tool to determine if a JV is the most appropriate way forward for a public sector body in relation to the range of conventional and private sector solutions available. This should be done through a full business case and assessment of value for money (VfM) based around the principles set out in HM Treasury's Green Book² and associated guidance such as the 5-case model³ and OGC's Policy and Standards Framework⁴.

1.7 This Guidance is also intended to supplement but not replace other framework documents such as HM Treasury's *"Managing Public Money"*, *"Consolidated Budgeting Guidance"* and *"Financial Reporting Manual"* and related documents for health, local authorities and the devolved territories. It should be read in conjunction with other JV guidance currently available in the public domain, such as HM Treasury's guidance on Trading Funds⁵.

Applicability of this Guidance to different public sector bodies

1.8 The term "public sector body"⁶ is used in this Guidance to refer to central departments and their agencies. It also covers non-departmental public bodies (NDPBs) and any other body controlled and mainly financed by them, local government, and public corporations, including government-owned companies, trading funds and NHS trusts.

1.9 The origin of this Guidance lies in the use of JVs for central government in England but the basic principles set out in this Guidance should be of assistance to all public sector bodies across the UK contemplating commercial JVs. Devolved administrations however have their own specific statutory systems and there may also be sector specific issues which need to be taken into account; e.g. local authorities in Scotland may be subject to different rules to local authorities in England⁷.

What is meant by a "joint venture"?

1.10 The term joint venture can describe a range of different commercial arrangements between two or more separate entities. Each party contributes resources to the venture and a new business is created in which the parties collaborate together and share the risks and benefits associated with the venture. A party may provide land, capital, intellectual property, experienced staff, equipment or any other form of asset. Each generally has an expertise or need which is central to the development and success of the new business which they decide to create together. It is also vital that the parties have a 'shared vision' about the objectives for the JV.

1.11 It is important to distinguish the formation of a JV entity from purely contractual arrangements, such as contracts for the provision of goods or services or a concession, whereby a public sector body gives a third party (the "concessionaire") the right to provide services to the

² HM Treasury Green Book ([www.hm-treasury.gov.uk/d/1\(4\).pdf](http://www.hm-treasury.gov.uk/d/1(4).pdf)).

³ Public Sector Business Cases using the Five Case Model ([www.hm-treasury.gov.uk/d/1\(3\).pdf](http://www.hm-treasury.gov.uk/d/1(3).pdf) and [www.hm-treasury.gov.uk/d/2\(3\).pdf](http://www.hm-treasury.gov.uk/d/2(3).pdf)).

⁴ OGC Policy and Standards Framework (www.ogc.gov.uk/procurement_-_the_bigger_picture_policy_and_standards_framework.asp).

⁵ *Guide to the establishment and operation of Trading Funds* HM Treasury Central Accountancy Team, January 2001 (www.hm-treasury.gov.uk/d/Guide_to_the_Establishment_and_Operation_of_Trading_Funds.pdf).

⁶ Definition as adopted for ONS National Accounts, Whole of Government Accounts (WGA) and for public expenditure control. (nao.gov.uk/publications/nao_reports/00-01/000121es.pdf).

⁷ Note that in Scotland a limited partnership is treated as a separate corporate entity.

public in consideration of payment, e.g., tolls payable to cross a bridge forming part of a public highway.

1.12 A JV involves risk sharing; it is suitable where a jointly owned and managed business offers the best structure for the management and mitigation of risk and realisation of benefits whether they involve asset exploitation, improved public sector services or revenue generation. It should not be seen as a delivery model in which the public sector seeks to transfer risk to the private sector through the creation of an arm’s length relationship.

1.13 Table 1.A below provides further explanation of different forms of JV structure and highlights those covered specifically by this Guidance.

Table 1.A: Summary of JV models and extent to which they are included in this Guidance

| Type | Included? | Comment |
|--|--|--|
| Contractual partnering including the Private Finance Initiative (PFI) and concession arrangements with no corporate status | ✘ key characteristics described in Chapter 2 for comparison | Whilst there are many examples of contractual PPPs and concession arrangements involving a wide range of public sector bodies these are not the focus of this Guidance; the most common form of PPP is the Private Finance Initiative ⁸ . |
| Non-profit-distributing e.g. company limited by guarantee (CLG) and industrial and provident societies (IPSS) | ✘ key characteristics described in Chapter 2 for comparison | These are common amongst housing associations, and in the leisure and third sectors. Many local authority non-regulated companies are CLGs ⁹ . Community interest companies (CICs) and charities also fall under this category. |
| Company limited by shares (CLS) | ✓ | This is the most common form of JV entity. Limited companies have also been used as an intermediary for stand-alone partnering contracts or ‘programme delivery partnerships’, e.g. the NHS LIFT Co and BSF LEP models ¹⁰ . |
| Limited partnership (LP) | ✓ | Here partners share directly in profit or losses in the proportion in which they invest their capital. LPs permit the existence of Limited Partner(s) and a general partner normally with unlimited liability. |
| Limited liability partnership (LLP) | ✓ | This is a relatively new form of JV - introduced in 2000; it is a hybrid combining the flexibility of a partnership with the safeguard of limited liability. |
| Other forms of ‘public: public’ partnership | ✘ | Guidance for local authority consortia, pooled budget and joint commissioning arrangements are set out in more detail in various CLG documents. |

1.14 Other PPP procurement approaches not covered by this Guidance include the “Integrator” approach, “Alliancing” and other “Hybrid” models such as project MoDEL¹¹ and ProCure21¹². These approaches are described in more detail in HM Treasury’s “Infrastructure procurement: delivering long-term value”.

⁸ www.hm-treasury.gov.uk/ppp_index.htm.

⁹ Other examples of local authority JVs include public:public development associations, tourism bureaux, sports stadia, airports, transport companies and waste.

¹⁰ See Chapter 2 for more details on NHS LIFT and BSF Local Education Partnerships (LEP).

¹¹ An MOD programme integrating the disposal of a number of surplus sites and the delivery of a construction programme in a self-funding contractual partnership.

¹² The DoH’s procurement framework which seeks to guarantee maximum price and share savings using an open book and pro-active risk management approach.

1.15 This Guidance assumes, for simplicity, that the JV entity will have two participants: one public sector and one private sector participant, though much of the material is still relevant if there are further public or private sector participants.

1.16 Annex A provides a sample of public sector JVs in addition to the specific case studies appearing in the main body of the Guidance.

When is a Joint Venture appropriate?

1.17 JVs are usually established because the parties have complementary objectives and share a view of the nature and scope of its activities and the JV's longer term objectives and benefits. This will need to be tested through the business case development and in most cases through a competitive procurement process. If this alignment of interests is not present, a JV is unlikely to be the best structure to use.

1.18 By contrast, if the public sector wishes to conclude arrangements which are clearly defined and limited in scope and with little or no potential for growth and diversification, or where risk transfer rather than risk sharing is sought, the public sector's objectives may be achieved more easily through a more straight forward contractual mechanism or through PFI.

1.19 Policy stability is especially important in the context of long term programmes. If the public sector body is not able to provide a satisfactory longer term framework within which the JV is able to operate, the JV and its business may struggle to meet these changing objectives. The JV management team may then be increasingly distracted from running its business and ultimately, should the parties' interests become misaligned, the basis on which the JV was formed will become invalid.

1.20 Box 1.A below describes the principal rationales for the public sector to enter into JVs with the private sector.

Box 1.A: When should the public sector consider forming JVs

Usually, for the public sector, the core reason for considering JVs is to mobilise complementary resources. The JV enables the complementary resources of the public and private sector parties to be integrated, so creating a wholly new business not otherwise achievable. Typically the purpose of the JV would stem from one, or a combination of the following objectives:

- **Value capture** - The desire to capture long term value, from say property development or a commercialisation/Wider Markets Initiative opportunity. A JV provides an alternative mechanism for capturing longer term value, as the public sector body will hold an equity stake in the JV.
- **Route to market** - The need to establish a new route to market for intellectual property or other assets, such as through the formation of a spin-out company from a Public Sector Research Establishment (PSRE) to establish and run a self-standing business. This is generally coupled with a desire to share in value capture as above.
- **Service delivery programmes** - The need to manage a long-term programme of service delivery and/or investment in order to improve the delivery and efficiency of public services and infrastructure justifies the formation of a separate self-standing and sustainable organisation. This would include e.g. Building Schools for the Future and Local Education Partnerships (see Chapter 2, example 4).

1.21 In some instances the public sector may be procuring a partner for a JV which later may then enter into contracts with the same public sector body. Where this happens, the public sector body should keep clear separation between its role as a JV partner and its role as a client. If it has concluded that a JV is an appropriate structure with which to achieve its objectives, by

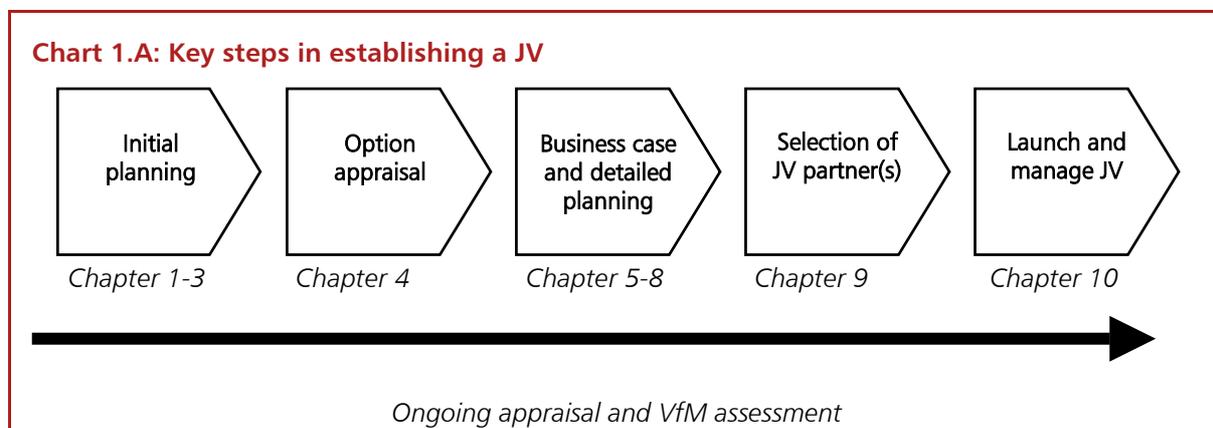
implication it considers that a new entity with specific defined objectives which meet the needs of the public sector body (the JV) is a suitable delivery vehicle. Commercial sponsors will likely (and reasonably) consider that the JV will best achieve those objectives if it is allowed to focus on them, with any broader perspective being left to the authority in its role as client.

1.22 A more detailed 'checklist' of factors supporting the use of a JV is also provided in Annex J. The factors listed in Annex J could be used as the basis for an evaluation framework.

Key steps in setting up a JV

1.23 An overview of the typical key steps and actions for a public sector body to take in order to set up a JV is shown in Chart 1.A below. The Chapters in this Guidance have been set out broadly in the order of the steps described in Chart 1.A, albeit a number of the steps will require iterative consideration.

1.24 In any event, following initial consideration and planning the public sector body should prepare an outline business case or 'business plan' consistent with HM Treasury's Green Book and associated general guidance¹³ and where applicable other best practice material relevant to the public sector body.



Initial planning

1.25 Before considering the detailed issues set out in this Guidance, it is essential that the public sector body undertakes an initial analysis to assess whether the JV proposition has a sound business or service delivery rationale that is commercially viable and likely to offer the best VfM to the public sector.

1.26 Once the public sector body is satisfied that the underlying business fundamentals warrant the formation of a JV, it should examine the issues for early consideration set out in Chapter 3. In particular, different types of public sector body have different legal powers, different funding regimes, different governance arrangements, internal resources and access to advice – all these may have implications for what is achievable and appropriate given the scale of activities involved.

Option appraisal

1.27 Next the public sector body should consider VfM issues and conduct an appropriate appraisal in accordance with HM Treasury and OGC guidance (Chapter 4). It is imperative that a public sector body carries out an appropriate investment appraisal and feasibility study to consider other potential delivery models, such as concessions, contractual service/supply

¹³ Public Sector Business Cases using the Five Case Model ([www.hm-treasury.gov.uk/d/1\(3\).pdf](http://www.hm-treasury.gov.uk/d/1(3).pdf) and [www.hm-treasury.gov.uk/d/2\(3\).pdf](http://www.hm-treasury.gov.uk/d/2(3).pdf)).

contracts and PFI to determine if a JV is the delivery model which will deliver best VfM and long term benefits to the public sector. The details of some of these issues will vary depending on the nature of the public sector body involved e.g. whether it is a government department, an NDPB, a local authority etc.

1.28 At this stage it is likely that the public sector body will need to consider the appointment of specialist financial, legal and technical advisers.

Business case and detailed planning

1.29 The public sector body should discuss with its sponsor department (and/or HM Treasury through the relevant spending team) at an early stage any novel, contentious or repercussive proposals and/or JVs likely to fall outside delegated approval limits. This is dealt with initially in Chapter 4. In addition, Chapters 5 to 8 outline some of the more detailed considerations relating to: the ownership, control and financial treatment of the JV (Chapter 5); tangible assets, staff and other resource issues (Chapter 6); initial and ongoing funding of the JV, fees and charges and tax considerations (chapter 7); and legal structuring and documentation for the JV (Chapter 8).

Selection of JV partner(s)

1.30 A public sector body should normally expect to have to competitively procure a JV partner, although there may be some exceptions where the EU public procurement rules may not strictly apply as set out in Chapter 9. Chapter 9 builds on the introduction to competition and procurement issues set out in Chapter 3 including typical selection processes and selection criteria applicable to a JV.

Table 1.B: Indicative activities to consider at key stages of JV establishment

| Initial Planning | Option appraisal | Business case and detailed planning | Selection of JV partner(s)* | Launch and manage JV |
|---|--|--|---|--|
| <ul style="list-style-type: none"> o Agree business scope and objectives o Benefits realisation o Confirm legal powers o Consider reputation and propriety issues o Likely classification, accounting and other regulatory matters o Identify staff and other resources issues o Project governance arrangements o Market analysis and research | <ul style="list-style-type: none"> o Appoint advisers o Initial due diligence on assets/IP o Initial valuations o Preliminary appraisal of project/delivery options o Initial legal, financing, technical, tax accounting, reviews o Identify any decisions needed in relation to key issues e.g. State Aid, competition rules, classification, etc o Further market sounding | <ul style="list-style-type: none"> o Work up detailed proposals for JV: <ul style="list-style-type: none"> - legal structure - asset transfers - staff transfers - financing o Establish procurement approach o Governance and management o Exit and termination strategies o Assemble material for info. o Decide selection criteria o Prepare outline heads of terms agreement | <ul style="list-style-type: none"> o Issue of information memorandum o Pre-qualify bidders o Enter dialogue phase* o Agree initial form of business plan o Agree forms of document o Call for final tenders o Identify preferred partner(s) o Bidders undertake due diligence | <ul style="list-style-type: none"> o Final business case approval o Fine tune documents o Finalise and monitor business plan o Launch JV o On-going resourcing and management of JV |

* Assuming competitive selection is undertaken using the competitive dialogue procedure, see Chapter 9; it is however possible that a restricted procedure may also be appropriate.

Launch and manage JV

1.31 Finally, issues around the launch of the JV and on-going management of the public sector interest in the JV will need to be considered (Chapter 10). In particular Chapter 10 adds to the issues raised in Chapter 3 relating to governance arrangements, public sector appointments to the JV and confidentiality and conflicts of interest.

2

What structures can a joint venture take?

Chapter 1 provided an overview of the use of JVs by public sector bodies and specified the scope of this Guidance and the type of JV to which it applies. This Chapter provides a further introduction to the main forms of JV covered by this Guidance and their key characteristics.

This Chapter sets out:

- the common features and characteristics of JVs;
- the principal forms of JV entity, specifically focusing on:
 - JV companies
 - the use of JVs as an intermediary for partnering contracts
 - partnerships with limited liability status
- the key advantages and disadvantages of alternative JV structures, and
- examples of their use in the public sector.

Common Features

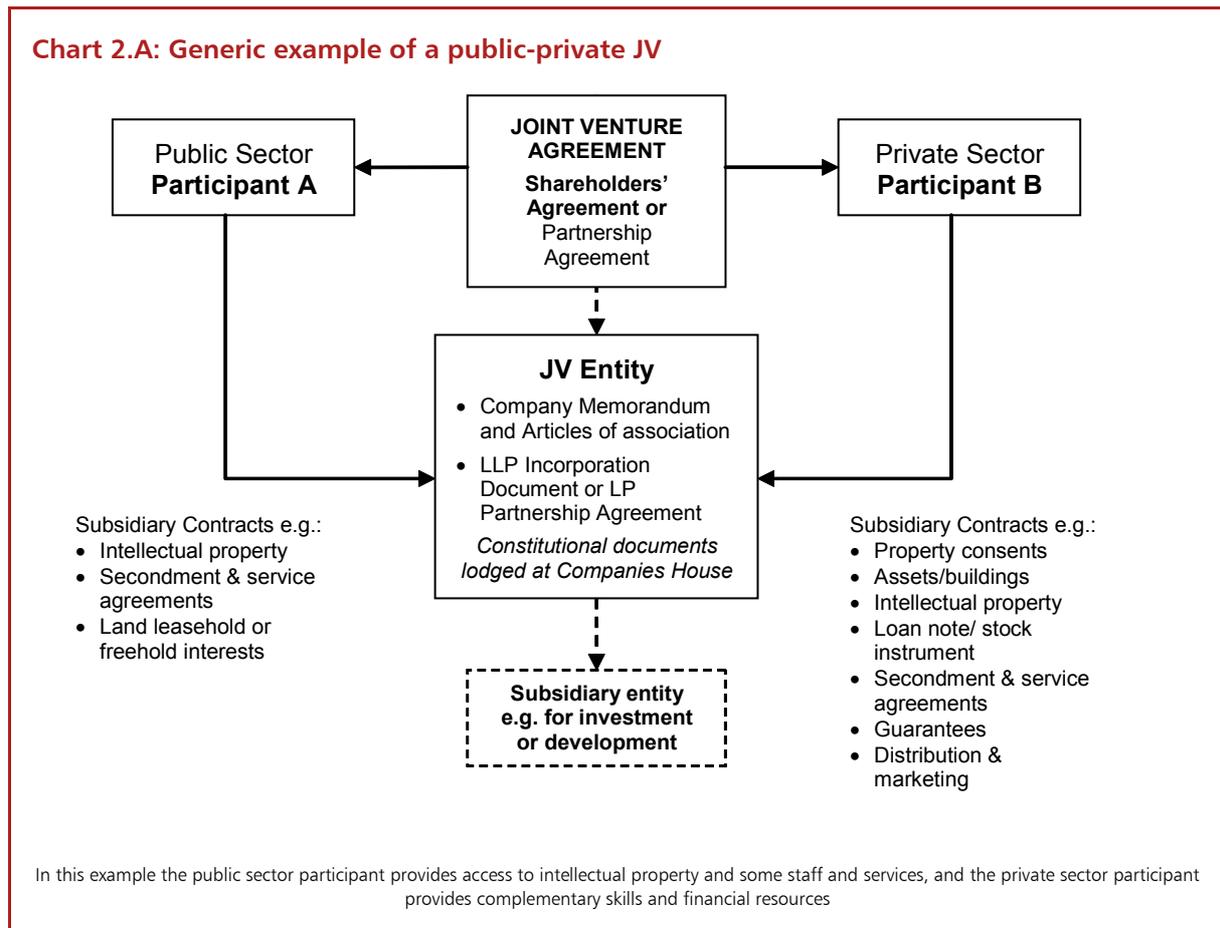
2.1 Table 2.A (at the end of this Chapter) sets out the range of possible JV structures and the extent to which they are covered by this Guidance. For the purposes of this Guidance the JV can be viewed as either a company or a partnership. Annex B provides a more detailed comparison of three of the principal forms, i.e. companies limited by shares, limited partnerships and limited liability partnerships.

2.2 The parties who form the JV as shareholders in a company or members of a partnership are referred to in this Guidance as “participants”. Those individuals responsible for the management of a JV are called “directors” (even though an individual with management duties within a partnership is not a “director” and does not have the same powers and duties as a “director” of a company) and references to the “Board” refers to the management committee of the JV, comprising the directors, responsible for the management and direction of the JV’s activities. Directors nominated by the public sector body participants may or may not have any direct relationship with the particular public sector body or they may be employees or non-executive directors.

2.3 In each case there will be an agreement between the participants in the JV. Where the JV is a company this normally takes the form of a Shareholders’ Agreement; in the case of a partnership, usually this is the Partnership Agreement. In this Guidance, this agreement is referred to in both scenarios as the “JV Agreement” (detailed information on the nature and content of JV Agreements is set out in Chapter 8).

2.4 Where the JV participants provide skills and incidental assets to the JV, this is often done under separate contracts (referred to in this Guidance as “subsidiary contracts”). For example, a participant may license existing intellectual property rights to the JV, lease or license land to the JV or second the staff required to carry on the JV’s business (Chapter 6). The terms of these subsidiary contracts will impact upon the liabilities of the participants and the value of the JV.

2.5 Chart 2.A below illustrates a generic example of a public-private JV, which could be either a company or a partnership.



2.6 The different types of JV structure are briefly introduced with example case studies in the remainder of this Chapter.

Joint venture company limited by shares

2.7 In a JV company the shares or membership interest will be owned by the public sector and private sector founding participants and there will be a Board of Directors who will have legal responsibility for managing the JV.

2.8 The board and/or the executive management will make most of the decisions on the running of JV. Some matters will require shareholder approval. Issues associated with the setting up and management of JVs are set out in more detail in Chapters 8 and 10.

2.9 The shares or membership interest of the JV will be owned by the public sector body and a private sector participant (the JV's "founding participants", who will become the JV's "shareholders" when it is established). The shares may be held in any proportion, such as 50:50, 75:25 etc.

Example 1: Customer Services Direct (CSD) Ltd

CSD (Customer Service Direct Ltd) is a JV between BT, Suffolk County Council and Mid-Suffolk District Council providing employee services for HR and ICT support to over 30,000 council staff. CSD also provides an online facility, via its website, (as well as a customer contact centre) to make payments, find information and report problems or submit requests for Council Services.

The business objective of the JV company is to provide enhanced services, whilst containing the cost of provision. A key requirement of the JV is investment in the replacement of legacy assets with modern solutions, requiring innovative working practices.

In 2007 the organisation was short listed for GC Awards for Innovation.

Source: CSD Ltd website

UK "general" and "limited" partnerships

2.10 There are a number of different types of partnership which can be formed under English Law.

2.11 Broadly, in an "unlimited" partnership the liability of each partner is unlimited and each is liable to third parties for the liabilities incurred by the partnership. In a "limited" partnership the liability of some partners is limited but the liability of at least one partner must be unlimited.

2.12 An unlimited partnership is unlikely to be a suitable model for a public sector JV and is not considered further in this Guidance. There are also potential limitations on the use of partnership structures in the public sector, particularly on local authorities (see Chapter 3).

2.13 In England and Wales¹⁴ a limited partnership created under the Limited Partnerships Act 1907 is not a separate corporate entity. In a limited partnership, the liability of some partners (called the "limited partner(s)") is limited but the liability of at least one partner (called the "general partner") must be unlimited. The general partner (with unlimited liability) will be the partner with the responsibility for the conduct and management of the limited partnership's activities. Limited partners cannot participate in the management of the partnership without losing limited liability status.

2.14 In many cases the general partner (with unlimited liability) is a newly formed limited liability company (SPV) in which the JV partners are shareholders. These shareholders effectively use this SPV as the general partner to enable them to indirectly participate in the management of the partnership whilst retaining limited liability status. It is vital that the SPV (and not the shareholders in it) manage the limited partnership's activities. This creates a 'two-tier' arrangement which is more complicated than other corporate entities as two agreements are needed, one JV agreement for the limited partnership and a second for the SPV limited company to manage the partnership.

2.15 Limited partnerships have been structured in this "two-tier" way in many urban regeneration and other property development arrangements. This choice of vehicle is often driven by the tax advantages available for certain types of property investor; tax exempt funds generally obtain preferential tax treatment where they enter into a limited partnership (such advantages not being available with a limited liability partnership, despite tax transparency, or limited company).

¹⁴ In Scotland a limited partnership is treated as a separate corporate entity.

Example 2: 'NorwePP' limited partnership property JV

In December 2006, NorwePP, a public private partnership, was launched by the North West Regional Development Agency (NWDA) and Ashtenne Industrial Fund (AIF) to manage and develop the Agency's portfolio of commercial property.

AIF was selected as preferred bidder in September 2006 and the 50-50 limited partnership JV gives AIF an equal stake in the portfolio. NorwePP holds 42 commercial properties situated across the Northwest region, but mostly in Merseyside and West Cumbria.

The use of private sector expertise and finance is intended to improve the performance of the portfolio, particularly in respect of providing accommodation for companies to create employment within the region. NWDA-allocated resources for managing these properties will be channelled into the strategic development of sites, to meet the regeneration objectives set out in the Regional Economic Strategy (RES).

Source: Northwest RDA website

UK Limited Liability Partnerships

2.16 In a limited liability partnership (LLP), the liability of each partner is limited through the Limited Liability Partnership Act 2000. As noted above under UK general and limited partnerships, there are potential limitations on the use of partnership structures in the public sector, particularly by local authorities (see Chapter 3).

2.17 A LLP combines features of both a UK partnership and a UK limited company and it can be formed to carry on any business. Frequently they are used when the members require fiscal transparency as each member of a LLP is treated for UK tax purposes as being directly in receipt of its share of the profits or losses of the LLP (whether of an income or capital nature). Note that different jurisdictions use different structures, e.g. a Scottish LLP is different to an LLP set up under the law of England and Wales.

Example 3: 'Forest Holidays' 50:50 limited liability partnership

The Forestry Commission (FC) recognised that their holiday business had a greater potential and would benefit from external investment and holiday sector expertise, so in 2004-2005 they undertook a selection process to find an experienced partner to run Forest Holidays (FH) and to invest in existing and new sites. The objective was to develop a first class holiday business and to set Forest Holidays apart from its competitors. Following the competitive process, a JV entity was formed with the Camping and Caravanning Club to which the FC granted 75 year leases of the sites, the FH brand and business and a first, exclusive, opportunity to search for and develop further sites across the 1 million hectares of the FC's estate.

The FC chose a JV arrangement as not only was it contributing assets and a going concern, it had a great deal to offer to the future development of the FH business. The FC manages most of the land surrounding the existing FH camp and cabin sites and, as the largest landowner in Great Britain, is key in supporting the future expansion of the business. A 50:50 deadlocked LLP was chosen as the corporate form of the JV following careful consideration of the existing form of the two JV partners, the desired governance and management arrangements for FH, as well as the treatment of future revenues and investors.

Source: Partnerships UK plc and Forest Holidays

2.18 The members usually enter a JV Agreement setting out their mutual rights and duties, as previously described in this Chapter and further detailed in Chapter 8.

JV Company linked to a strategic infrastructure partnership

2.19 There are scenarios in which a public sector body may choose to establish a JV company as an intermediary vehicle for a wider programme delivery or 'strategic infrastructure' partnership. This approach can be beneficial in reducing the risk, during the early years, of a failure of the partnership by limiting the necessity for comprehensive up-front commitment. Moreover, the case for using a JV may arise from an objective of establishing a self-standing and sustainable delivery organisation.

2.20 Strategic infrastructure partnerships (also referred to as incremental or programme delivery partnerships) might be considered where there is commitment to an extensive change programme, e.g. to modernise or process re-engineer a significant area of public service delivery capability. This approach has also been used in the cases of the NHS Community Health Partnership local LIFT vehicles and Building Schools for the Future (BSF) Local Education Partnerships (LEPs) to support the delivery of a long-term strategic vision partnership for transforming community health and educational outcomes.

2.21 Programme delivery partnerships of this type can be relatively complex and bespoke. As such this Guidance does not deal with them specifically although many of the same principles still apply. Further information on Community Health Partnerships 'LIFT' and BSF Local Education Partnership (LEP) models can be found on their respective websites¹⁵.

Example 4: NHS LIFT and BSF LEP strategic infrastructure JVs

An incremental partnership approach has been followed by the DoH to introduce capital investment into the health and social care sector through the NHS LIFT project.

The underlying principle in NHS LIFT is the appointment, following an EU compliant competitive selection process, of a partner to form a JV company (LIFT Co) with public sector participants (generally PCTs and local authorities). LIFT Co contracts to deliver identified and priced specimen projects and also to provide services to the public sector participants by way of developing potential new projects against that initial framework. LIFT Co has a period of exclusivity during which it has the right of first refusal to deliver new projects. All new projects must be market-tested to demonstrate VfM pricing.

A similar model has been introduced for investment in secondary schools (Building Schools for the Future or BSF).

Source: CLG Structures for Service Delivery Partnerships, 2006

Public service delivery JVs

2.22 Increasing competition for resources and a drive towards greater plurality in the use of the private, not-for-profit and third sector markets in the provision of front-line service has already been a factor in the establishment of a number of JVs. Example 5, below, provides one such example of the use of a JV to deliver long-term service delivery efficiency in the provision of back offices services to NHS bodies.

¹⁵ www.communityhealthpartnerships.co.uk and www.partnershipsforschools.org.uk.

Example 5: Delivering shared service efficiency in the NHS through the SBS Ltd

NHS Shared Business Services Ltd is a 50:50 joint venture partnership between the Department of Health and Groupe Steria S.A. which was set up in 2005 following an OJEU procurement process. It is now working with over 100 NHS bodies using recognised best practice processes and systems to deliver a range of back-office corporate services to the NHS. It uses external benchmarking to determine how efficiently it operates and the 2009 review places their Accounts Payable operation in the top quartile of all providers, worldwide.

NHS Shared Business Services has achieved operational efficiencies for the NHS of between 20% and 30% in savings. Overall it has already delivered savings in the order of £40m across the NHS. In addition to efficiencies and savings, all profits due to the Department of Health as dividends will be shared amongst the customer base of NHS Shared Business Services.

Source: Department of Health

Many public service market outsourcing/commissioning processes may result in the externalisation of existing public sector provided services into social enterprises. Social enterprises are normally constituted using a non-profit distributing structure, e.g. a CLG, CIC or IPS (see Table 1.A) and typically there is no retained public sector ownership of the entity. Social enterprises and non-profit distributing structures are outside the scope of this Guidance however further information can be obtained from the Social Enterprise Coalition.¹⁶

2.23 There are also circumstances where an existing in-house public sector body provider may wish to participate in a JV with private and/or third-sector provider(s) in the provision of public services. It would be normal to expect the JV to have to compete for the services, however exceptions may apply (see Chapter 9). Advice should be sought on the most appropriate selection and appointment process for the JV partner(s), which may differ depending on whether the JV subsequently competes for the services under the EU rules or not.

2.24 Any public sector body considering such an approach should evaluate at an early stage the risk implications, possible conflicts of interests between its role as investor and commissioner, impacts on the competitive process and wider market implications. Particular consideration should be given to the procurement and competition implications and need to maintain a level playing field. (Chapter 9 dealt in more detail with procurement and competition law issues).

2.25 There are particular difficulties in using such a JV approach in the context of bidding for a PFI project, in particular the impact on the risk transfer arrangements and performance mechanisms should be carefully considered.

Comparison of alternatives JV structures

2.26 Table 2.A overleaf provides a summary level comparison of the main forms of JV structure contrasted with contractual partnering arrangements. For completeness the Table also includes Companies Limited by Guarantee (CLG) although these are not covered in detail within the rest of the Guidance.

2.27 Annex B provides a more detailed side-by-side comparison of the principal operating differences and characteristics of the main JV structures covered by the Guidance, namely companies limited by shares (CLS) and UK limited partnerships (LP) and UK limited liability partnerships (LLP).

¹⁶ Social enterprises are businesses trading for social and environmental purposes. Further information can be obtained from the social enterprise coalition (www.socialenterprise.org.uk).

2.28 Annex G provide a similar comparison focusing on the key differences in taxation between companies and UK partnerships.

2.29 The remainder of this Guidance is generally focused on JVs using a CLS or UK partnership structure however many of the issues apply equally to other models.

Table 2.A: Summary features of main JV structures for comparison

| Type of JV | Advantages | Disadvantages | Public Sector Examples | Comments |
|--|---|--|--|--|
| Contractual Partnering | <i>Contractual partnering may be suitable where there are clearly defined and time-limited tasks to be undertaken. It is a more static and potentially less flexible model than a JV. It can have benefits of simplicity but where a contract starts to make detailed provisions for future decision-making it may prove more straightforward to align interests from the outset using a "structural" rather than "contractual" approach.</i> | | | |
| No corporate vehicle | <ul style="list-style-type: none"> Contractual structure is familiar to the public sector and may be regarded by some as lower risk than a JV Defined "horizon" and exit strategy in contract Can be effective when operating in a predictable environment, or where the partnering arrangement is expected to be a short one | <ul style="list-style-type: none"> Parties work less closely, relying more on the contract, potentially leading to disputes Contract must foresee all eventualities Less flexible and less able to manage change Potential inadvertently to create a partnership imposing joint and several liability on parties | <ul style="list-style-type: none"> MOD Estates in London (MoDEL) Private Finance Initiative (PFI) projects | Can achieve the same objectives as a JV using a separate legal entity. These arrangements operate best when the environment is static and predictable. |
| Corporate JV | <i>JVs embed partnership working and genuine risk sharing. Provides flexibility and allows decisions to be made in an efficient manner.</i> | | | |
| Company limited by shares (CLS: a limited liability company with shareholders) | <ul style="list-style-type: none"> Flexible and familiar structure Simple mechanism for introduction of new equity/transfers Limited liability for shareholders Appropriate risk sharing and management Can convert to a PLC or a CLG Corporate management structure allows a degree of independence from shareholders CLS can distribute dividends Rewards are linked directly to risks taken, generally in direct proportion to the proportion of shares held | <ul style="list-style-type: none"> Potential conflict of interest for public sector directors, particularly for profit distributing structures Maintenance of share capital requirements – less flexibility on withdrawing equity Tax at JV Company level at up to 30% – no credit for non-tax paying investors Cannot make distributions to shareholders in excess of distributable profits Value issues arise on transfer of membership | <ul style="list-style-type: none"> BBC Worldwide DSTL Acolyte Partnerships UK | <p>A company limited by shares is a well recognised form of JV and accepted by the private sector. Even if private sector classified, there remains flexibility for public sector controls through reserved voting matters.</p> <p>Shareholders' influence is linked to the proportion of shares held and the rights reserved to shareholders.</p> |

| Type of JV | Advantages | Disadvantages | Public Sector Examples | Comments |
|---|--|---|--|---|
| Company limited by guarantee (CLG: a limited liability company with members) | <ul style="list-style-type: none"> • Can convert to unlimited liability company, but not to a limited liability company • Flexible structure for a “non profit distributing” venture • Appropriate risk sharing and management • No value issues created with membership interest, it is easier for members to join and leave • Limited liability | <ul style="list-style-type: none"> • Potential conflict of interest for public sector directors although as CLG is non-profit distributing risk may be lower than CLS • Rewards are linked directly to risks taken • Termination, voluntary or involuntary, of the company could result in a financial loss • Difficult for CLG to make distributions although still legally possible • CLG regarded as being less flexible than CLS | <ul style="list-style-type: none"> • Welsh Water • Network Rail • Local Authority Companies | CLG has no limit on participants, and the board structure is likely to be similar to that of a CLS. Set-up costs of simple CLS may be less than of a CLG, however for complex structures the set-up costs are likely to be approximately equal. |
| Limited Liability Partnership (LLP: a limited liability partnership with members) | <ul style="list-style-type: none"> • Corporate body with limited liability • Transfer of equity/introduction of new members flexible • Flexible basis for profit distributions and return of capital • Tax transparent, so non-taxpayers do not suffer tax leakage • Tax efficiency • Investors in partnerships can get back their capital more easily than from corporate entities | <ul style="list-style-type: none"> • Less familiar structure, though becoming more widely understood • Transfer of interests may be subject to stamp duty of 4% • Lack of case law in event of a dispute • Potential limitation for local authorities to trade through a partnership | <ul style="list-style-type: none"> • Forest Holidays • British Waterways (ISIS) | Broadly speaking the main perceived benefit of a LLP or LP is that profits are taxed at member level only. In a limited company there may be “double” taxation liability, as corporation tax may be chargeable at company level, and may be chargeable on dividends at shareholder level. |
| Limited Partnership (LP: a limited partnership controlled by a general partner typically set up as a CLS) | <ul style="list-style-type: none"> • Limited liability for limited partners • Flexible basis for profit distributions (e.g. not necessarily in proportion to invested capital) • Tax transparent, so non-taxpayers do not suffer tax leakage • Tax efficiency • Investors in partnerships can get back their capital more easily than investors in corporate entities since the company rules on capital repayments only apply to companies | <ul style="list-style-type: none"> • Not a separate corporate entity • Can be inflexible – limited partners cannot be involved in management • Unlimited liability for general partner • Less easy to introduce new members/transfer equity – transfer of an interest must be by way of assignment so that the prohibition on capital withdrawals is not breached • Limited partners cannot withdraw capital • Asset ownership can be complex | <ul style="list-style-type: none"> • EM Property Investment Fund (Blueprint) • PXP West Midlands • One Northeast (B4B and ONEDIN) | See comments for LLP above. |

3

Issues for early consideration

Chapters 1 and 2 establish some key principles of a JV and the forms a JV might take. Early consideration should next be given to the factors which can determine at a high level whether or not JVs have the potential to meet the public sector body's objectives. In particular, questions such as whether it is acceptable to operate with reduced public sector controls, and the extent to which it is possible to transfer risk effectively to appropriate parties (including in the event of failure of the JV) need to be thought through.

The aim at this stage is to check whether there are inherent issues that would prevent a JV option being taken forward. This Chapter sets out some specific issues that the public sector body should consider at an early stage in determining if a JV is appropriate for their needs. This includes:

- the business scope and benefits which the JV is expected to deliver and potential risks;
- exit arrangements and consideration of any associated public service delivery implications;
- whether it has the legal power to enter a JV entity for the desired purpose;
- reputation risk;
- control and delegation issues; and
- possible competition, procurement law, State Aid and other statutory implications.

Business scope, benefits and risks

3.1 Before progressing with the establishment or procurement of a proposed JV the public sector body must conclude that each party to the JV is able to deliver its required aims and objectives and that the JV provides the best VfM solution. In particular the public sector body should ensure that any equity holding will justify the value of assets (whether cash or non-cash) which it is contributing. The approach to VfM assessment is described further in Chapter 4.

3.2 In most JVs (particularly 'route to market') early consideration should be given to the required investments and returns and the likely longer term sustainability and attractiveness of the business plan from inception to exit. Initial assessment of project risk is also important e.g. if it is intended that the JV takes on developer risk, how much risk is involved, what is the likelihood of risk crystallising and is it worth the potential returns?

3.3 Consideration of the long term viability of the business should include sources of funding (debt and equity), the investment returns needed to create a sustainable business, projected revenues, liabilities and profit. Funding arrangements, identified in the business plan and to cover unforeseen events, should be addressed as these can considerably dilute the control of the public sector when it is unwilling or unable to contribute additional funds to the JV (see also Chapter 8).

3.4 A key matter for the public sector body, when setting up a JV, is establishing the risks it is taking and those which are assumed by the JV and allocating responsibilities for managing those risks. This will involve obtaining timely information, making contingency plans, and being alert

for opportunities as well as risks. The aim is not to eliminate risk, but to manage the risk:reward ratio across the risk portfolio¹⁷.

Powers

3.5 It is vital that a public sector body planning the formation of a JV entity should first consider whether it has the necessary powers, and in particular:

- that it has the legal powers to participate in a JV entity;
- that it is not using its powers for an improper purpose or unlawfully delegating its powers;
- that it has the powers necessary to cover the business activities of the JV;
- that it understands which, if any, limitations on its powers will apply to the JV - e.g., if the public sector body is unable to borrow money, will such limitations affect the JV?
- that it has monies to spend on the JV which have been properly voted (if applicable) and powers related to expenditure on it; and
- that it is acting in a way that is compatible with other policy or legal requirements.

3.6 All decisions or actions by a public sector body must be within the powers (*intra vires*) of that body. Depending on the type of public sector body, the powers will be set out in a variety of places such as statute, statutory instruments, trading fund orders¹⁸, company memorandum and articles of association, trust deeds etc., and may also exist in common law. If a public sector body acts outside the scope of its powers (*ultra vires*) then that decision or action is invalid and is unauthorised by law.¹⁹

3.7 The rules governing public sector powers are highly complex and constantly evolving through case law. Legal advice should be taken to ensure that any public sector body has the power to do each proposed activity under the JV proposals. In-house lawyers within the public sector body will be the first source of guidance as they will be familiar with the source of an authority's powers and their application.

3.8 Example 6 below provides an example of statutory powers, in this case as applied to the DCSF building schools for the future programme.

3.9 Where a public sector body does not have the necessary powers, it should not take the development of the JV further without first consulting its sponsor department and key external stakeholders to assess whether obtaining the necessary powers is desirable or feasible within a reasonable period.

3.10 The public sector should not expect potential private sector participants to commit any significant money to the venture until it is certain that it can proceed. If, however, it is considered necessary to begin partner selection before then, the public sector body must ensure that it complies with any existing limits on its legal powers and spending authority.²⁰

¹⁷ The NAO backs up this message in its report *Supporting Innovation: Managing Risks in Government Departments, 2000* (www.nao.org.uk/publications/9900/managing_risk_in_gov_depts.aspx).

¹⁸ *Guide to the establishment and operation of Trading Funds* HM Treasury Central Accountancy Team, January 2001. Available from the HM Treasury website: www.hm-treasury.gov.uk/d/Guide_to_the_Establishment_and_Operation_of_Trading_Funds.pdf.

¹⁹ An example of this happening is the case of Credit Suisse vs Allerdale Borough council. For details, see Rob Hann, *Local Authority Companies and Partnerships – Tottels* (updated bi-annually).

²⁰ Public sector bodies must comply with all relevant HM Treasury budgetary and accounting framework policy and guidance.

Example 6: DCSF Investment through Building Schools for the Future

DCSF is able to invest in investment vehicles as part of the Building Schools for the Future programme in accordance with the Education Act 2002.

This Act authorises the Secretary of State, “if he considers it expedient to do so for purposes connected with any function of his relating to education” to form or participate in forming companies to carry on activities he considers likely to secure or facilitate the achievement of those purposes, or invest in any company which is to carry on such activities.

Pursuant to the Act DCSF would therefore be able to invest in a JV (such as a CLS or CLG company). Under the Act investment may take any form, including grants, loans, guarantees and the incurring of expenditure for the benefit of the person assisted.

Source: *Partnerships UK plc*

Local authorities

3.11 So far as local authorities are concerned the activities which the JV entity intends to undertake will determine what powers the local authority would need to rely upon in setting it up. There is a general power contained in Chapter 2 of the Local Government Act 2000 which a local authority may often rely upon. This allows a local authority to do anything which it considers likely to promote the social, economic or environmental wellbeing of its area. Local authorities should also consider any limitations on this power, in particular the prohibition on using this power to “raise money”.²¹ Local authorities also have a power to trade in function-related activities, although any such trading premised on that power must be through a company rather than, e.g., a LP or LLP partnership.²²

NHS Bodies

3.12 NHS bodies have powers to enter contractual and other joint arrangements²³, but of Primary Care Trusts (PCTs) and NHS trusts have fewer freedoms to participate in separate JV entities.

3.13 The powers of PCTs and NHS trusts to form companies can be broadly divided into two categories: income generation and Public Private Partnerships.

3.14 In relation to income generation, PCTs and NHS trusts have powers to form, participate, invest in companies for the purpose of making additional income available to the health service (or, in the case of NHS trusts, in order to better to perform their functions).²⁴ It is important to note that the scope of this power is limited to companies. It would not extend to limited liability partnerships. There are other limitations attached to these powers and in relation to PCTs and NHS trusts Department of Health directions and guidance are available regarding the exercise of these powers.²⁵

3.15 In relation to Public Private Partnerships, the Secretary of State may also form or participate in companies to provide facilities or services for NHS purposes.²⁶ Again, this power is limited to companies and does not extend to the formation of limited liability partnerships. The power

²¹ See Section 3 of the Local Government Act 2000.

²² See Section 95 of the Local Government Act 2003.

²³ See section 12 of, and paragraph 15 of Schedule 3 to the National Health Service Act 2006 (Primary Care Trusts), paragraphs 14 and 18 of Schedule 4 (NHS trusts) and sections 43 and 47 (NHS foundation trusts).

²⁴ See section 21(5) of the National Health Service Act 2006 (PCTs), paragraph 20 of Part 2 of Schedule 4 to the National Health Service Act 2006 (NHS trusts) and sections 43(3) and 46 of the National Health Service Act 2006 (NHS foundation trusts).

²⁵ National Health Service Income Generation – Best Practice (DH February 2006); and Department of Health Guidance: The Use of Companies in Income Generation by the NHS (1 April 2005).

²⁶ See section 223 of the National Health Service Act 2006.

may be exercised by PCTs and NHS trusts in so far as it is delegated to them. At present, the only delegation that has been made has been to enable PCTs to form LIFT companies.²⁷ No such delegation has been made to NHS trusts. As such NHS trusts may only establish companies using their income generation powers.

3.16 NHS foundation trusts, on the other hand, have broader powers to establish and to participate in “bodies corporate” (not just companies) for the purposes of or in connection with their functions which could include income generation activities²⁸.

Reputation

3.17 In order to protect the reputation of the public sector body, its sponsors and stakeholders, the public sector body should consider as early as possible issues where there may be potential for the JV to make decisions or act in a manner contrary to the public interest (e.g. security) or contrary to wider policy objectives. Many of the propriety considerations in selecting a partner will be the same as for commercial sponsorship of government activities and are set out in Cabinet Office guidance.²⁹ Consideration should also be given to ensure civil servants act in line with the principles of public life identified by the Committee on Standards in Public Life.³⁰

3.18 More generally, the commercial success or otherwise of the JV may bring reputation concerns to the fore – does the authority wish to be associated with a very profitable venture, or with a financially unsuccessful one potentially failing to deliver high-profile services such as leisure or cultural services? Public bodies can be seen as lenders of last resort and there may be pressure to fund loss-making ventures they are closely connected with – but not entirely in control of – for political reasons. Reputation issues could also arise if the JV is seen to be paying excessive salaries or bonuses.

3.19 Protection may be needed if the JV’s name is closely linked to that of its public sector participant. In such cases, the public sector parent will need to ensure that it can insist on a change in the name of the JV if it ceases to have a significant interest in the entity.

3.20 The public sector body will need to consider the most suitable approach to alleviate any such concerns and protect its reputation.

3.21 Depending on the relevant issue, protection could be sought as outlined below:

- an express provision in the JV Agreement imposing a contractual obligation on the JV and/or the private sector participant;
- where the JV is a company, a provision in the Memorandum and Articles (e.g. the objects clause which sets out the nature of the business);³¹
- reservation of the matter to be decided by the participants, and an express right of veto for the public sector (whatever the percentage participation of the public sector body); or
- adoption by the JV of a specific “corporate policy”.

²⁷ Regulations 3(2) and 8(3) of, and Part 2 of Schedule 1 to, the National Health Service (Functions of Strategic Health Authorities and Primary Care Trusts and Administration Arrangements) (England) Regulations 2004.

²⁸ See section 46(4) and (5) of the National Health Service Act 2006.

²⁹ *Guidance to Departments on Sponsorship of Government Activities*, Cabinet Office, updated May 2007.

³⁰ The seven principles are: selflessness, integrity, objectivity, accountability, openness, honesty and leadership. See the Committee on Standards in Public Life website at: www.public-standards.gov.uk.

³¹ It should be noted that provisions in the Memorandum and Articles of Association can be changed by a party with more than 75% ownership of a company. Companies Act 1985, as amended by Companies Act 1989. However, under the Companies Act 2006, from 1 October 2009 a newly incorporated company will not have a Memorandum of Association and the Memorandum of an existing company will be treated as part of its Articles of Association.

3.22 The public sector body should ensure that the controls it puts in place do not undermine the JV's ability to be effective in delivering the objectives for which it is being established. In addition, in the light of recent ECJ cases,³² any "golden share" or similar rights reserved by public sector bodies to maintain control and prevent a JV from take-over may now be deemed a breach of a member state's obligations under Article 56 EC (free movement of capital). The public sector body will also need to keep in mind that if it includes too many controls, it may affect whether the JV is classified to the public or private sector (see Chapter 5).

Controls and Delegation

3.23 Public sector stakeholders and the relevant Monitoring Officer and/or Chief Executive, or the Accounting Officer need to be satisfied with the consequences flowing from the fact it will be setting up a JV that may have a separate legal capacity and have to be allowed by law to make its own decisions, employ people, and enter into contracts etc. Consideration should be given to any public accountability, ministerial responsibilities and audit requirements.

3.24 The level and manner of public sector control over the JV will have significant impact on its classification and accounting treatment (see Chapter 5) and may have State Aid implications (see 3.35 below).

3.25 Other key issues will include the degree and nature of delegations, governance and the roles and responsibilities of the partners (as set out in Chapters 8 and 10).

3.26 It is important that the JV management is given real responsibility (see also Chapter 10). If too many matters are labelled as "reserved matters" for the shareholders to take away and decide outside the forum of the Board, the management may feel disenfranchised and become frustrated.

3.27 The governance arrangements will be considered in the assessment of the classification treatment of the entity for the national accounts (see also Chapter 5). There may also be a risk that the public sector body puts itself in the position of a shadow director.³³

3.28 Unless there is an overriding policy reason for intervention, the business of managing the JV should be done by the management board of the JV itself and not taken outside it. If there is insufficient policy stability or excessive public sector intervention, the JV may not be a success.

3.29 When considering the business of the JV a balance must be struck between granting a functionally important role to the JV whilst ensuring that a public sector body does not delegate activities other than those it is permitted to by Statute (e.g. pursuant to an order under the Deregulation and Contracting Out Act 1994).

3.30 It is also important that the staff of the public sector body engaged in negotiating the JV have the necessary skills, or access to those skills through advisers, and have clear responsibilities and a well-thought through incentive structure. Potential conflicts of interest will also need to be considered and managed (see also Chapter 3).

Exit arrangements

3.31 The exit arrangements for the public sector and the other parties need to be thought through, as do the duration and expiry issues related to any contract(s) with the public sector body. All JVs come to an end at some point when the original purpose for which the JV was established is complete, or as a result of differences between the JV participants.

³² See *Commission v French Republic*, C-483/99, 4 June 2002.

³³ A shadow director is a person or any legal entity deemed to be fulfilling the role of a director under the Companies Act 2006 and subject to some of the same regulatory controls and accountability as a "proper" director.

3.32 The general issue of whether the public sector is content that the JV could end or fail, bearing in mind any responsibilities for public service delivery that have been transferred, should be discussed and a clear view developed as to how failure would be managed in terms of the authority's responsibilities, e.g., by a managed transition fully into the public or private sector. It is very important in this context to understand the likely exit ambitions of the private sector parties.

3.33 Unless it is clear that there is such policy and commercial stability that commonality of interests will be sustained on a long-term basis, the public sector should contemplate an end state where it is no longer involved in the JV, where either the JV has been successful in its own right or its job is done. Exit issues including those related to staff and assets are dealt with in greater detail in Chapter 8.

Competition law and procurement issues

3.34 Unlike Competition Law, which will apply in all instances, the EU Public Procurement Rules may not strictly apply to the formation or procurement of a JV. Even where there is no strict requirement to apply the EU rules to the selection of a partner the principles derived from the EU treaties may still apply. Early analysis of the competition and procurement issues should be undertaken.

3.35 In most cases a public sector body should start with the assumption that some sort of competition will be required to select a suitable partner. Competition and procurement issues are dealt with in detail in Chapter 9. This is a complex area and public sector bodies should seek legal advice in relation to the possible implications of competition law and procurement issues.

State Aid

3.36 State Aid is the giving of financial advantage by the state to certain undertakings over others, which has the potential to distort trade between EU member states and the potential to distort competition. It can give rise to complex deliberations about what is or is not acceptable practice by public authorities. The European Commission has considerable powers to monitor, control and ultimately prohibit the forms and levels of aid provided to commercial undertakings by EU Member States or through State resources.³⁴

3.37 In the context of JVs the risks of problems arising could be mitigated by ensuring parity in terms between the public and private sectors and the use of a competitive procurement to find the JV partner. State Aid considerations do not apply only when a JV is set up – they apply to any of the various ways in which financial advantage might be given by the state so this could include exit arrangements or transactions during the life of the JV.

3.38 State Aid rules need not be a large hurdle to overcome, especially if the JV is set up with the rules in mind from an early stage in the project. An analysis of the State Aid position should therefore be undertaken at an early stage.

3.39 The application of the rules can be complex and if there are any doubts related to specific projects these should be addressed at an early stage to the State Aid Branch at BIS³⁵ or legal advice sought. Further information on State Aid can also be found in Annex C.

³⁴ This includes public funds administered by the Member State through central, regional, local authorities or other public or private bodies designated or controlled by the State.

³⁵ BIS State Aid Branch, email: bis.enquiries@bis.gsi.gov.uk or telephone 020 7215 5000 .

4

Value for money and other appraisal considerations

Chapters 2 and 3 considered some of the early issues related to the formation of JVs. Before progressing with the establishment of a proposed JV, the public sector body will need to establish that the JV is able to deliver their required aims and objectives, and that it potentially provides the best VfM solution.

The business cases and option appraisals will need to consider affordability issues alongside VfM and take into account the wider implications of Competition Law and other commercial issues.

The focus of this Chapter is:

- overview of the appraisal of JVs and typical drivers of VfM;
- options appraisal;
- affordability considerations;
- asset and other resources; and
- development stage project governance.

Value for Money ("VfM") and the appraisal of JVs

4.1 VfM can be defined as *"the optimum combination of whole life costs and quality (or fitness for purpose) of the good or service to meet the user's requirements. VfM is not the choice of goods or services based on the lowest cost."* VfM will therefore be achieved by finding the optimal balance between benefits and costs taken over the long term.

4.2 The VfM assessment and appraisal methodology advocated for JVs is to follow a business case approach. This involves a staged process where, to increasing levels of certainty, compelling and coherent cases are made for the proposed action. This process should be in accordance with existing guidance and policy, such as the Green Book³⁶, the 5 Case Model³⁷ and OGC's Policy and Standards Framework.³⁸

Procedure

4.3 At initial stages, a Strategic Outline Case (SOC) and an Outline Business Case (OBC) are needed to consider, at a strategic and programme level, whether a JV, when compared with other options, has the potential to be an appropriate, desirable, and workable means of the delivering the required outcomes. Governance systems should be employed to test and approve the emerging case for action.

4.4 After further work and formal engagement with potential partners, the process should conclude with a Full Business Case (FBC) which should be presented and finally approved through the appropriate governance arrangements prior to the formation of the JV. The relevant parts of the FBC should consider in depth the drivers of potential VfM and how they are

³⁶ HM Treasury Green Book, ([www.hm-treasury.gov.uk/d/1\(4\).pdf](http://www.hm-treasury.gov.uk/d/1(4).pdf)).

³⁷ Public Sector Business Cases using the Five Case Model, ([www.hm-treasury.gov.uk/d/1\(3\).pdf](http://www.hm-treasury.gov.uk/d/1(3).pdf) and [www.hm-treasury.gov.uk/d/2\(3\).pdf](http://www.hm-treasury.gov.uk/d/2(3).pdf)).

³⁸ OGC Policy and Standards Framework (www.ogc.gov.uk/procurement_-_the_bigger_picture_policy_and_standards_framework.asp)

to be delivered, and provide an explanation of the benefits, drawbacks and risks of a JV compared with other delivery options. The aim is to provide a balanced and cogent case for pursuing a JV.

Indicative drivers of VfM in a JV

4.5 Chapter 1 introduced some of the key drivers of VfM and purpose for selecting a JV approach.

4.6 It is essential that the public and private sector parties have complementary and aligned objectives. Each party will have a contribution to make to the delivery of a successful partnership outcome and both will share in the risks and rewards, many of which may be relatively difficult to quantify fully at the outset. Through the JV these complementary resources can be integrated to create a wholly new business, not otherwise achievable.

4.7 In addition to the need for complementary objectives and shared risks and rewards, other factors supporting the use of a JV approach may include, amongst other things: the need for a more autonomous and formalised corporate governance and management/control framework; access to finance and private sector resources; and a more flexible delivery structure. These and other factors supporting the use of a JV are explained further in Annex J.

Options appraisal

4.8 VfM is a comparative concept, and so it is important that any JV option is considered alongside other real delivery options. The analysis of the JV and other potential delivery options must include a full assessment of the benefits, drawbacks and risks. It is important to draw out the various drivers and constraints that affect VfM that are relevant to different options.

4.9 The delivery options should be analysed and be subject to both quantitative and qualitative analysis to ensure that the chosen delivery option is the one best able to deliver VfM. In assessing different delivery options at each of the different business case stages a balance should be struck between qualitative and quantitative factors. The nature of many JVs will be such that the decisive aspects are more likely to be qualitative, particularly those that relate to increased focus, flexibility, agility and the better management of risks.

Qualitative assessment

4.10 When considering JVs as a potential option the aspects described in Box 4.A below should be considered alongside the drivers, set out above and in Annex J, as part of the appraisal presented in the business case.

Box 4.A: Specific JV business case constraints

- **Transaction costs** - the work should cover the proposed business model for delivering the strategic aims and objectives now and in the future, including details (for each party) of what is being contributed, risks and responsibilities, respective activities and the potential synergy of bringing the different participants together (financial and non-financial).
- **Future dilution** - if successive rounds of funding are likely to be required then the public sector should work through the implications of it being unable to contribute additional funds to the JV, e.g., on its returns and controls.
- **Risks and responsibilities borne by the public sector** – the risks held by the public sector need to be fully understood, and the public sector has to be comfortable that it has the capacity and capability to fulfil any tasks or other responsibilities placed on it, and recognise the impact of its failure to do so.
- **'Director' responsibilities** - these need to be understood.
- **Exit and/or Buy-out** – the implications need to be thought through and consequences considered.
- **Dispute resolution and deadlock** – the method of dispute resolution and deadlock breaking need to be considered as these have an impact on the level of control and risk to the public sector body.

Quantitative assessment

4.11 The quantitative assessment methodology for considering PFI against public sector delivery (see HMT VfM assessment guidance)³⁹ utilises a public sector comparator as a baseline, adjusting for risks and discounting future costs and revenues using an NPV approach. A replication of this approach is however **not** considered appropriate when looking at a JV delivery option alongside other delivery options. Rather the recommended approach is to focus on estimating the monetary value of the potential benefits of JVs (see Annex J), using where appropriate an expected value approach, and comparing this to a valuation of potential disadvantages (see Box 4.A), such as increased transaction costs and risks borne by the public sector. This approach seeks to convert any non-financial benefits into expected values, creating a “should cost” or “worth” model for the JV delivery option that can then be compared with the “should cost” or “worth” of other viable delivery options to show the potential for relative benefits. Sensitivities should be run to examine the effect of changes in major assumptions and to estimate the tipping point for switching from one option to another.

4.12 However, even with the appropriate use of sensitivities it must be recognised that in this context a quantitative approach is an inexact science and difficulties will often be encountered in estimating expected values. Notwithstanding that the discipline of undertaking a quantitative analysis is in itself beneficial to understanding the venture, it is better to understand and articulate the drivers of VfM without detailed spreadsheet modelling and it is generally preferable to base the decision on a clear explanation of the qualitative factors. The quantitative assessment should then be used to inform and to scale the potential benefits and disadvantages – to elaborate on and support the picture provided through qualitative analysis where necessary. In practice, the two elements of the analysis might proceed in parallel, with quantitative results informing consideration of the qualitative appraisal and vice versa.

³⁹ HM Treasury Value for Money Assessment Guidance, November 2006 (www.hm-treasury.gov.uk/d/vfm_assessmentguidance061006opt.pdf).

Approvals process

4.13 Public sector bodies seeking to establish a JV, whether they are Local Authorities, Departments, Agencies, NDPBs, etc, will need to ensure they have an internal corporate scrutiny mechanism which is capable of providing for effective VfM appraisal and formal sign-off of any JV proposal.

4.14 In addition sponsoring departments, where the JV relies on material levels of central funding (whether direct or indirect) or where formal consents are required, will also need to ensure they have an effective corporate internal scrutiny mechanism. The scope of this responsibility is not limited solely to those bodies for whom the department is ultimately accountable e.g. NDPBs and agencies, but any public sector body e.g. Local or Regional bodies if their JV relies on material levels of funding from the sponsoring departments, in particular if delegated limits for spending have previously been established, or consented, particularly where the transfer/sale of assets are involved.

4.15 In both cases this may mean convening a separate group of interested parties from around the public sector body. This should bring together those with the appropriate skills and expertise to understand the legal and funding risks associated with the proposal. At all levels there should be clarity established at an early stage over the approval process and who has sign-off responsibility. In the case of a sponsoring department this would normally involve senior departmental officials i.e. the Policy senior responsible officer (SRO), Head of Legal or Director of Finance. In the case of a local authority this would potentially be the Section 151 officer (i.e. the senior responsible accounting officer) and SRO for the project.

4.16 In the case of a project which requires approval from a sponsoring department the public sector body will need to determine whether the proposal should ultimately also be submitted to HM Treasury for approval, either given the novel and contentious nature of the proposal, if appropriate, or if it exceeds the delegated limits agreed with HM Treasury for this type of transaction.

4.17 Public sector bodies need to be aware in the particular context of JVs that delegated limit decisions need to take account not just of the capital value of the proposal but also the value of any assets being used in the JV and the whole life cost of the project if services represent a significant element. For example, this would apply if the proposal relates to a transfer of assets which are greater than the value of the equivalent delegated 'expenditure' limit. In such circumstances Departments should discuss with their counterparts in HM Treasury how best to scrutinise the project and at what stage the department needs to approach HM Treasury for formal approval. To assist in this process, HM Treasury is considering how its own scrutiny processes, such as the Project Review Group (which currently reviews only PFI Projects), can be improved to provide more effective scrutiny of PPPs, including JVs, to ensure these projects receive an appropriate level of expert scrutiny and are deemed deliverable, VfM and ready to go to market.

Affordability

4.18 Business cases should also examine, and at the appropriate point use the governance process, to confirm the affordability of the JV option. Affordability in this context is defined as ensuring that the projected publicly funded capital (including the accounting treatment of any assets being transferred) and operating expenditure (after risk adjustment) forecast to be needed to deliver the aims and objectives detailed in the strategic case are, year by year, covered by the relevant budgets allocated by the public sector body responsible.

4.19 Affordability is a constraint, so the relevant business case should reach a clear conclusion as to whether the JV option is affordable or not. The business case is limited to consideration of

public sector funding, and so for JVs where the bulk of the investment capital will be provided by the private sector the case may be limited to looking at transaction, ongoing resources and any public sector dependencies and asset transfers. In these circumstances the ability to raise the private sector investment will of course be a vital consideration for the OBC.

Other appraisal considerations

Funding and pricing assumptions

4.20 Any expenditure incurred by the public sector body on the JV must come within the powers, expenditure limits and controls of the public sector body. For JVs set up to sell products, the business case will need to include assumptions of the JV's future revenue, based on assumed future prices and volumes of sales. Pricing assumptions should not be made without checking on the relevance of HM Treasury rules⁴⁰ and possible legal restrictions such as those contained in *The Competition Act 1998* (see also Chapter 7).

Tangible and intangible assets

4.21 The public sector body will normally have to contribute assets to the JV, and agree to this in principle at an early stage. It must therefore ensure that it has correctly identified the relevant assets, and that the assets are capable of being used for the intended purpose. It also needs to ascertain that it either owns the relevant assets, or has the necessary consents or permissions to use the assets and transfer them to the JV or, in the case of intellectual property rights, to license them to the JV as required. Chapter 6 provides further detail on the use of public assets and resources in JVs. It should also consider the accounting treatment of any asset transfer.

Resources

4.22 The public sector body needs to identify the people within its organisation, or externally, with the necessary skills to:

- negotiate the deal with the private sector and form the JV (including specialist tax, legal and financial advisers);
- act, if required, as directors of JV; and
- work in the JV on secondment or as an employee of the JV, if appropriate (see Chapter 6).

4.23 The business case will also need to consider what resource the public sector body will need to have in place internally in the ongoing management and monitoring of the JV.

4.24 Potential directors will need to be made fully aware of their duties as a director. Where there is a potential conflict between the interests of the JV and of the public sector body, or for the individuals involved, it may be sensible from an early stage to restrict the participation of the "public sector" directors in the negotiations on behalf of the public sector body. Chapter 10 provides further details on directors' duties and conflicts of interest.

Development stage project governance arrangements

4.25 With JVs it is very important that the required project governance arrangements are considered in advance and implemented in good time as the formation of a JV typically raises novel issues for a public sector body. Such arrangements need to be implemented with

⁴⁰ *Managing Public Money*, Chapter 6, section 6.4.2.

particular regard to project sponsorship and to the management of consultations with stakeholders.

4.26 Further guidance on the project governance arrangements post formation of the JV is given in Chapter 10.

5

Ownership, control and financial reporting

Chapter 4 introduced, amongst other things, the issue of control as a key area for early consideration and highlighted its relationship with classification and financial reporting. Public sector bodies will need to consider a number of questions regarding the JV's classification and accounting treatment, and subsequently keep them under review.

The main issue of classification will be whether the JV is considered a public or private sector body in the UK's national accounts. There are a range of issues which can affect the sector classification of the body which are particularly relevant to JVs.

This Chapter considers the wider issues related to the levels of public sector control, classification and financial reporting in the formation of JVs. The focus is on:

- determining factors of classification and ownership delineation within the public sector;
- analysis of the main implications of public/private classification;
- financial reporting, auditing and other financial services regulations;
- contingent liabilities and guarantees.

Note that the separate issue of whether or not the JV is a "contracting authority" under EU public procurement rules is dealt with in Chapter 9.

Classification issues

5.1 It should always be recognised that issues of classification are secondary in importance to those of establishing control or governance structures for the JV that provide best VfM and best protect the public sector's interest in the JV. Nevertheless, classification will be important to participants as it determines the budgetary and financial control framework under which the body will operate. The same public/private classification issues apply to JVs that are partnerships.

5.2 The Office for National Statistics (ONS) is the body responsible for determining the classification of companies into the public or private sector within the national accounts; it makes its decisions in accordance with the guidelines in the European System of Accounts (ESA).⁴² Since the national accounts classification is utilised by HM Treasury in determining the appropriate financial and budgetary controls for public sector bodies, it can advise on the likely national accounts classification but the final decision is made by the ONS.

5.3 All public sector bodies have a mandatory requirement to report expenditure according to HM Treasury's budgeting standards; in order to comply with this they must get a national accounts classification in respect of any new bodies where they have been involved in their set-up.

⁴² For further details on the ONS procedure, ESA system and individual classifications (www.statistics.gov.uk).

5.4 Theoretically classification should be one of the last stages in the establishment of the JV, however, for practical reasons the public sector body may wish to clarify the issue of the JV's classification, as far as is practical, before engaging formally with the private sector.

5.5 Full details of the process for classifying a new body, or extant bodies, is contained in HM Treasury's Classification Information Pack⁴³. A summary of the process is described in Box 5.A below.

Box 5.A: Process for attaining a classification

Step 1

- The public sector participant may be liaising with HM Treasury to discuss policy formulation, and implementation issues involved in setting up a JV as set out in Chapter 4.
- Although HM Treasury is able to provide advice to public sector participants at any point during the process of designing a new body, procuring authorities should also consider obtaining their own professional advice so they are fully aware of the impacts of classification of the JV on themselves.
- The HM Treasury's role can include providing provisional classification decisions for planning purposes and advice on the key points that lead to different sector classifications. Participants should recognise that these opinions may differ from the final decision of the ONS. This is especially relevant to JVs, where controls over the body are split between two sectors.

Step 2

- HM Treasury will write to ONS to request a classification decision presenting all of the governance documents and a completed classification questionnaire for the JV. ONS cannot be involved in the policy formulation process so are unable to provide advice to participants; all contact with ONS is through HM Treasury.
- The earliest point at which ONS can be consulted on a classification is once near-final governance documents are in place and the participants have completed a classification questionnaire. ONS will not classify bodies where information is incomplete or likely to change. This makes it even more vital that accounting officers in the procuring authority consider seeking professional advice to get an early view on the likely classification if the implications of whatever the ONS's final decision could be material.
- Classification by the ONS is a detailed process and is subject to the resource constraints of ONS's business areas. When planning the process to set up a JV, participants should allow at least twelve months for a classification decision.

Step 3

- ONS will write to HM Treasury to give their decision and the reasoning behind it. HM Treasury will then write to the public sector participant to convey the decision, set out what it means for budgets, and what further action needs to be taken. HM Treasury will also forward the decision to Cabinet Office for classification within Cabinet Office's typology.
- ONS's decision is final and will not be reconsidered unless there is a material change to the structure of the body, or additional information is provided that HM Treasury consider sufficient to alter the body's national accounts status. In such cases, HM Treasury will approach ONS with the new facts.

⁴³ Latest version of Classification Information Pack available from (www.hm-treasury.gov.uk/d/classification_pack.pdf).

5.6 Public sector bodies should assure themselves at an early stage, seeking appropriate professional advice where appropriate, that the classification decision (the process for which is set out below) would not have a material impact on the business case approval as set out in Chapter 4. This means that any risks associated with the ONS's ultimate view and any changes to the way classification is assessed would need to be borne by the public sector body (as appropriate). This may require letters of assurance, e.g. from the senior responsible accounting officer at local authority level or accounting officers at departmental level, to be submitted as part of the approvals process outlined in Chapter 4 to ensure the implications of these issues are fully understood at a high level.

5.7 Within the public sector, there are three sub-sectors to which a body can be attributed in the national accounts: central government; local government; and public corporations. Table 5.A describes the key characteristics and provides examples.

Table 5.A: Example classifications

| | Characteristics | Examples |
|---------------------|--|---|
| Central Government | <ul style="list-style-type: none"> public sector controlled non-market UK-wide remit separate institutional unit | Government departments and their agencies, the devolved administrations, most non-departmental public bodies. |
| Local Government | <ul style="list-style-type: none"> public sector controlled non-market local remit separate institutional unit | local authorities, bodies owned and controlled by local authorities. |
| Public Corporations | <ul style="list-style-type: none"> public sector controlled market producer separate institutional unit | government owned companies, nationalised industries, most trading funds. |

5.8 If a body is controlled by general government (central or local government) or a public corporation, then it will be in the public sector. If not, then it will be in the private sector. So the key question that needs to be addressed to determine whether a body is in the public sector or the private sector is “who controls the body?” ESA 95 defines control as the ability to determine general corporate policy; this control may arise through a variety of means.

5.9 HM Treasury’s Sector Classification paper includes full guidance on the technical detail of how bodies are classified within the national accounts framework, including the various mechanisms for control.⁴⁴ For convenience, examples of control issues taken into account by ONS are included in Annex D.

5.10 Simplistically, if the public sector has more than a 50% participation in a JV, it will have control, and the JV will typically be classified to the public sector.

5.11 If a body is a 50/50 (deadlock) JV with neither partner having overall control over the Board, then national accounts require it to be classified as private sector. However in these cases the ONS would look very closely at all possible controls to check whether the public sector partner had any extra powers above those held by the private sector participant.

5.12 The equity interest of the public sector must reflect the value of the assets which it contributes and the public sector should not agree to a participation in a JV of less than 50% simply to avoid public sector classification. Participants should note that where participation is less than 50% to the public sector the body will still need to go through the classification process to be classified within national accounts.

⁴⁴ Latest version of Sector Classification paper available from www.hm-treasury.gov.uk/d/classification_pack.pdf.

5.13 Notwithstanding classification, where significant borrowing, capital expenditure or use of assets is anticipated through a JV, guidance should be sought from the sponsor department and the relevant HM Treasury expenditure team at an early stage.

5.14 Public sector bodies are required to account for their relationship with other entities under the relevant financial reporting standards, as set out above and in Annex E, taking note of the requirements of the Financial Reporting Manual or appropriate accounts direction.

Implications of public/private classification

5.15 For the reasons set out above, classification to the public sector means that the assets, liabilities and transactions of the body will impact on the overall government fiscal position. Public sector bodies are therefore required to budget for public sector entities for which they are responsible. HM Treasury's consolidated budgeting guidance provides further details.⁴⁵

5.16 It is important to remember that a classification in the public sector does not make the public sector body participant liable for the JV's debts, any more than a private sector classification makes the private sector founder liable. The existence of limited liability follows from the legal set-up not from how the structure is accounted for or presented in the national accounts.

5.17 The main implications of public/private classification are set out in Box 5.B below.

Box 5.B: Main implications of public/private classification

- **Public expenditure controls and accountability:** public sector bodies may be subject to Parliamentary scrutiny, Managing Public Money principles, public expenditure control and disclosure requirements (including requirements of the Public Records Act and the Freedom of Information Act). For private sector JV companies, parliamentary accountability would usually be restricted to public money invested or granted to the venture. A key benefit would be greater flexibility in the use of private sector funding.
- **Attractiveness to private sector participants:** a private sector classified JV entity is likely to be perceived as more attractive to private sector participants who may otherwise be concerned about the potential for political interference and public sector controls fettering the JV's ability to operate effectively. The use of a CIC or CLG may however be less attractive than other JV structures.
- **Public sector interests:** public sector classification implies a greater degree of control by the public sector body as participant; however, a private sector classification could still allow sufficient scope to secure public sector financial and other interests through the JV's founding documents, e.g. through use of a deadlocked structure.

5.18 Classification issues may have different implications for different public sector bodies, in particular local authorities may arguably be less sensitive to the impacts in borrowing and capital expenditure terms since the introduction of the prudential borrowing framework. Nevertheless, a local authority may still be subject to revenue consequences.⁴⁶ Classification is still relevant in determining the extent to which local authority propriety rules should apply to the JV if it is deemed a regulated entity.^{47 48}

⁴⁵ HM Treasury *Consolidated Budget Guidance 2008/09* available from: www.hm-treasury.gov.uk/d/consolidated_budguid010208.pdf.

⁴⁶ See also Part 6 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 as subsequently amended.

⁴⁷ As governed by Part 5 of the *Local Government and Housing Act 1989* and the *Local Authorities (Companies) Order 1995*.

⁴⁸ HM Treasury has a reserve power in Part 1 of the *Local Government Act 2003* to impose borrowing limits on Local Authorities.

Budgets and treatment of transaction in budgets

5.19 Separately, the budgets of central government departments are set to ensure that overall public expenditure limits, as measured with reference to the national accounts produced by the ONS, are protected, as the classification by ONS of a JV may ultimately affect the budget of a sponsoring department including those introduced at local authority level. Where a department is involved in any way with sponsoring, approving or funding a JV it will wish to be involved in decisions relevant to its classification.

5.20 The relationship between the ONS statistical classification, financial accounts and the HM Treasury budget setting process is not straightforward. Both the national accounts and the financial accounts use an assessment of control that one entity has over another when considering how to describe that relationship. It must be noted however that they are different frameworks, produced under different standards and for different purposes. As such, a direct relationship cannot be automatically inferred and care must be taken to understand the implications of the new body for each of the financial accounts and the national accounts.

5.21 From a departmental point of view the main issue will usually be the impact of the new entity, if any, on its budgetary limits, meaning that the ONS decision is usually considered as key.

5.22 The treatment of a public sector body within HM Treasury's budgeting framework is determined by the national accounts classification. Details of the budgetary treatment for different types of public sector bodies can be found in HM Treasury's *Consolidated Budgeting Guidance*.⁴⁹

5.23 Since JVs are normally 'market bodies' the expected classification within national accounts would be either be public or private non-financial corporation.

5.24 The public sector participant will not record the transactions of the JV directly within its budget. Instead the participant would record its transactions with the JV, such as interest and dividends from the JV, or loans and subsidies to the JV. These will all score in budgets regardless of the overall classification of the body classification.

5.25 Whilst the majority of transactions will score in the same way in budgets whether the JV is a public corporation or a private sector body, any debt owed by the JV will score differently. If a private sector JV borrows money from the market it will have no impact on budgets. If a public corporation borrows money it will be a cost in the capital budget of the sponsor department; this cost is intended to reflect the fact that the debt will increase public sector net debt. Local authorities' debt is subject to the prudential borrowing regime, the debt of a local authority public corporation should be treated in the same way as borrowing by any other local authority subsidiary.

5.26 The net assets of departments are subject to a cost of capital charge/credit (COCC).⁵⁰ This is the opportunity cost of government holding assets rather than undertaking an alternative investment. Whilst the nominal rate of COCC is 3.5%, where the asset is an investment in a public corporation or a commercial operation then the charge should be increased to reflect better the risk and expected return. In the case of a JV the charge will be payable on equity or loan investments in the venture.⁵¹ Local government is not subject to cost of capital charging.

⁴⁹ Latest version of the Consolidated Budgeting Guidance available from www.hm-treasury.gov.uk/d/consolidated_budguid010208.pdf.

⁵⁰ Cost of capital charges are treated as part of the Departmental Expenditure Limit (DEL).

⁵¹ See HM Treasury *Consolidated Budgeting Guidance* for details on setting cost of capital rates.

5.27 Table 5.B overleaf sets out the indicative relationship between the financial accounting determination of an entity, the likely ONS classification and the budgetary treatment as well as setting out the key issues to consider under each of the frameworks.

Table 5.B: Financial reporting, classification and public sector bodies' budgets¹

| Financial Accounts prepared under the FReM | ONS classification and impact on the national accounts | Public sector body budgets |
|---|---|---|
| <p>Subsidiary undertaking Public sector body should consolidate a subsidiary only when:</p> <ul style="list-style-type: none"> • the entity in question is inside the public sector bodies accounting boundary; and • where the public sector body exercises in-year budgetary control over the entity, such that the entity is considered to be an extension of the public sector body². | <p>Public sector Entities accounted for as a subsidiary of another public sector organisation are likely to be considered public sector by the ONS, although this may not always be the case.</p> <p>Accordingly, transactions, assets and liabilities of these entities affect performance against the fiscal position.</p> | <p>Transactions recorded in line with the Consolidated Budgeting Guidance ("CBG").</p> <p>Central government bodies' transactions are recorded in the same way as subsidiary body transactions. Public Corporations are treated in line with the CBG.</p> |
| <p>Alternatively, any investment in a public sector classified subsidiary should be reported at historic cost, less any impairment. Investments in other entities should be held in accordance with the FRS 26/IAS 39³. Executive NDPB or Trading Funds should consolidate subsidiaries in accordance with the relevant standard⁴</p> | <p>A distinction is made in the national accounts between public sector market (Public Corporations) and public sector non-market bodies (General Government). This distinction affects the presentation of the overall public sector finances and performance against General Government statistics.</p> | |
| <p>JVs Public sector bodies show investments in public sector JVs at historic cost, less any impairment. Investments in entities outside the public sector should be held at fair value.</p> | <p>Public or Private sector The treatment as public or private sector depends on the ONS' view of the controls present. Where the entity forms part of the public sector then see section ONS 1.</p> | <p>Transactions <u>of</u> entities classified to central government are recorded in the same way as the parent or sponsor body. For Public Corporations see the CBG.</p> |
| <p>Executive NDPB or Trading Funds should account for JVs in accordance with the relevant standards⁴.</p> | <p>Where the entity is treated as being in the private sector any transactions with that entity will affect the reported fiscal position.</p> | <p>Transactions <u>with</u> private sector entities will score to the appropriate part of the budget in accordance with the CBG.</p> |
| <p>Associates Show investment in public sector associates at historic cost, less any impairment (although this scenario is unlikely). Investments in entities outside the public sector should be held at fair value.</p> | <p>Private sector Entities that are treated as associates are unlikely to be considered as public sector, although where government has a close relationship with the entity or any special rights care should be exercised before reaching this conclusion.</p> | <p>Transactions <u>with</u> private sector entities will score to the appropriate part of the budget in accordance with the CBG.</p> |
| <p>Executive NDPB or Trading Funds should account for associates in accordance with the relevant standard⁴.</p> | <p>Transactions at the boundary affect the fiscal position.</p> | |

¹ Note that this table is for indicative purposes only.

² See iFReM 4.2.12 – 4.2.14 and FReM 2.4.8 – 2.4.10

³ See iFReM 4.2.4 and FReM 2.4.3 and 9.1.8c

⁴ For further guidance see Annex E.

5.27 Table 5.B overleaf sets out the indicative relationship between the financial accounting determination of an entity, the likely ONS classification and the budgetary treatment as well as setting out the key issues to consider under each of the frameworks.

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| <p>Subsidiary undertaking Public sector body should consolidate a subsidiary only when:</p> <ul style="list-style-type: none"> • the entity in question is inside the public sector bodies accounting boundary; and • where the public sector body exercises in-year budgetary control over the entity, such that the entity is considered to be an extension of the public sector body². <p>Alternatively, any investment in a public sector classified subsidiary should be reported at historic cost, less any impairment. Investments in other entities should be held in accordance with the FRS 26/IAS 39³. Executive NDPB or Trading Funds should consolidate subsidiaries in accordance with the relevant standard⁴</p> | <p>Public sector Entities accounted for as a subsidiary of another public sector organisation are likely to be considered public sector by the ONS, although this may not always be the case.</p> <p>Accordingly, transactions, assets and liabilities of these entities affect performance against the fiscal position.</p> <p>A distinction is made in the national accounts between public sector market (Public Corporations) and public sector non-market bodies (General Government). This distinction affects the presentation of the overall public sector finances and performance against General Government statistics.</p> | <p>Transactions recorded in line with the Consolidated Budgeting Guidance (“CBG”).</p> <p>Central government bodies’ transactions are recorded in the same way as subsidiary body transactions. Public Corporations are treated in line with the CBG.</p> |
| <p>JVs Public sector bodies show investments in public sector JVs at historic cost, less any impairment. Investments in entities outside the public sector should be held at fair value.</p> <p>Executive NDPB or Trading Funds should account for JVs in accordance with the relevant standards⁴.</p> | <p>Public or Private sector The treatment as public or private sector depends on the ONS’ view of the controls present. Where the entity forms part of the public sector then see section ONS 1.</p> <p>Where the entity is treated as being in the private sector any transactions with that entity will affect the reported fiscal position.</p> | <p>Transactions <u>of</u> entities classified to central government are recorded in the same way as the parent or sponsor body. For Public Corporations see the CBG.</p> <p>Transactions <u>with</u> private sector entities will score to the appropriate part of the budget in accordance with the CBG.</p> |
| <p>Associates Show investment in public sector associates at historic cost, less any impairment (although this scenario is unlikely). Investments in entities outside the public sector should be held at fair value.</p> <p>Executive NDPB or Trading Funds should account for associates in accordance with the relevant standard⁴.</p> | <p>Private sector Entities that are treated as associates are unlikely to be considered as public sector, although where government has a close relationship with the entity or any special rights care should be exercised before reaching this conclusion.</p> <p>Transactions at the boundary affect the fiscal position.</p> | <p>Transactions <u>with</u> private sector entities will score to the appropriate part of the budget in accordance with the CBG.</p> |

¹Note that this table is for indicative purposes only.

²See iFReM 4.2.12 – 4.2.14 and FReM 2.4.8 – 2.4.10

³See iFReM 4.2.4 and FReM 2.4.3 and 9.1.8c

⁴For further guidance see Annex E.

Other accounting and reporting issues

5.28 Public sector bodies need to ensure they have the necessary statutory powers (see Chapter 3) and authority through Estimates to incur expenditure and receive receipts from the JV, or become exposed to other liabilities such as through indemnities, which may require a change to the 'ambit' or preambles to the Vote.⁵² Even if the JV is classified to the private sector, the relevant Accounting Officer will be responsible for regularity, propriety and VfM of public expenditure on the JV. Any such expenditure, and information relating to it, will be subject to scrutiny by Parliament and the Comptroller and Auditor General or Audit Commission.

5.29 The public sector body needs to consider carefully the implications of guaranteeing or indemnifying the JV against any risks. It should avoid taking any actions which give rise to any unnecessary potential liabilities. In addition to this being good sense, where any representations, warranties or indemnities are provided it must confirm that it has the necessary powers to do so. Where guarantees and the like are provided, the public sector body should consider the need for financial cover.

5.30 The JV will need to produce accounts in line with its accounting policy, which will depend on the classification of the JV as either public or private sector and any legal requirements under the Companies Act or other establishing legislation.

5.31 The way in which the results and assets and liabilities of the JV are recorded in the accounts of the public sector body will depend on its relationship with the JV (the extent of its involvement in, and control over, the day-to-day management of the JV) and whether the public sector body is included in the resource accounting boundary.

5.32 For accounting purposes, the public sector body's relationship with the JV can be classified as that of a subsidiary, associate or 'JV' (in a narrower sense than used elsewhere in this Guidance). The way in which subsidiaries, associates and 'JVs' should be incorporated in a public sector body's accounts is summarised in Annex E.

5.33 Public sector subsidiaries, associates and JVs (narrowly defined) may be incorporated into Central Government Accounts and/or Whole of Government Accounts.⁵³

5.34 Private sector auditors will be appointed to audit the accounts of the JV. The public sector parent's auditor (whether the Comptroller and Auditor General or a private sector auditor) will also look at the public sector parent's expenditure and income from the JV, as well as the financial information on the JV which appears in the public sector body's accounts (see Annex E which sets out the accounting issues in more detail). The public sector body's auditor may need to go behind these figures to ensure that they provide a true and fair view of the public sector body's accounts. To do that the auditor may look to the JV's own auditors in order to obtain assurances. Authorities may wish to consider providing in the engagement letters for the JV's auditors that such assistance to its own auditors will be provided where necessary. It may also be prudent to provide for this requirement in the JV agreement drafting.

Financial services regulations

5.35 The Financial Services and Markets Act 2000 (FSMA) regulates activities including dealing, managing, advising and arranging deals in investments and operating collective investment schemes. The list of investments includes shares in any corporate body and units in a collective investment scheme which includes participations in certain unincorporated JVs.

⁵² See HM Treasury, *Supply Estimates: a guidance manual* October 2007.

⁵³ For details of the Whole of Government Accounts Programme see www.hm-treasury.gov.uk/psr_government_accounts.htm.

5.36 Section 19(1) of FSMA states that:

- “No person may carry on a regulated activity in the United Kingdom, or purport to do so, unless he is:
 - a) an authorised person; or
 - b) an exempt person.”

5.37 Under the FSMA (Exemption) Order 2001 certain persons are exempt from this general prohibition, but only in respect of certain specified regulated activities. Exemptions, some wider than others, have been granted to government organisations, local authorities, housing associations and registered social landlords, amongst others.

5.38 If a JV (the shares or other rights of participation in which are investments subject to FSMA) wishes to make a financial promotion then the JV would normally need to have the consent of the communication approved by a FSMA authorised person. A financial promotion is any invitation or inducement to engage in investment activity.

5.39 Legal advice should be sought as to the specific impact of FSMA and related regulatory requirements on the formation and activities of the proposed JV vehicle and the acquisition and transfer of shares and other rights of participation in the proposed JV vehicle. A bona fide commercial trading JV however (where both parties have day to day management control) is unlikely to be covered by FSMA.

6

Joint venture assets and resources

Chapters 1 to 5 have set out the background and key issues associated with public sector JVs together with the approach to considering VfM in the context of existing appraisal guidance such as the Green Book. The following Chapters 6 to 8 are intended to provide guidance on some of the more detailed commercial and legal issues to be considered in the development of the JVs.

The assets which the participants could contribute to the JV include staff, buildings, equipment, land, finance or intangible assets, e.g. intellectual property rights. These assets will form an important part of the structure of the business and should normally be provided under separate contracts (referred to in this guidance as subsidiary contracts) or directly through the JV agreement. The public sector body will normally contribute assets in return for equity in the JV, and it is therefore important that they are properly valued. Consideration should also be given at an early stage to how the assets should be dealt with on exit from or termination of the JV.

This Chapter outlines some general considerations on tangible and intangible assets contributed by the public sector, and provides more details on:

- tangible assets including land and property;
- intellectual Property (“IP”) provisions and considerations to take into account when the public sector contributes IP to the JV entity; and
- staffing and transfers of public sector staff to the JV entity.

Tangible assets

6.1 Tangible assets contributed to the JV could include anything from land, buildings, plant and machinery to software developed by the public sector. Where such assets are incidental to the main purpose of the JV they may simply be leased or licensed to the JV through subsidiary contracts.

6.2 The public sector body should obtain separate advice on the accounting, VAT, stamp duty and other tax implications on any disposal of tangible assets into a joint venture and the consequences on exiting the joint venture.

6.3 The remainder of this Chapter focuses on those situations where the purpose of the JV is the leverage of long term value from the assets or the commercialisation of the assets themselves. Particular focus is given to land and property assets although many of the principles will apply to other classes of tangible assets.

Disposal of tangible assets

6.4 In circumstances where a tangible asset is vested in the JV, the public sector body should ensure that, in the event of disposal of the asset, an appropriate share of the proceeds accrues to the Exchequer.

6.5 Managing Public Money (Annex 4.8 Asset Management) sets out the protocol for disposals of land, property and other assets. Further guidance on the disposal of surplus property is provided by the OGC⁵⁴ and in the *Green Book*.⁵⁵ The overarching protocol is that public sector bodies should dispose of surplus land and property within three years and should not hold land speculatively.

6.6 Central government bodies should identify disposals as part of their asset management strategies and would normally be expected to plan to use the proceeds. HM Treasury approval is usually required if departments do not have 'Estimate' cover for spending receipts and if sponsored bodies want to retain receipts from disposal of assets. Whilst local authorities are generally able to retain receipts some restrictions still apply (see below).

6.7 Disposal in such circumstances would normally imply an arm's length sale on the open market for the best possible monetary outcome, subject to wider VfM considerations. Disposal may include provision for 'clawback' or 'overage' arrangements where windfall gains are anticipated or it is difficult to determine the final value at the time of transfer.

6.8 In the case of land and property transferring to the JV it would still normally be expected that the public sector body has taken reasonable steps to maximise the value of surplus land prior to transfer, e.g. by obtaining outline planning consent or a planning brief for the most valuable alternative use. There are of course some JVs where part of the object of the venture is to prepare land for sale e.g. by undertaking remediation and clearance and obtaining planning consent. A list of issues is set out in Box 6.A.

Box 6.A: Issues to consider for land and property JVs

- Have ownership, title, liability, security and other due diligence issues affecting disposal been fully explored?
- Is there a possible requirement to 'offer back' to former owners if property was compulsorily acquired?
- For central departments, has surplus land first been offered for transfer between public sector organisations?
- What are the implications of public sector bodies' requirements to uphold wider policies such as sustainability and social or economic development on values?
- Are there particular sensitivities around the timing and levels of receipts if already incorporated into budget Estimate plans?
- Is the timing of the sale appropriate relative to the prevailing market?
- Are the current whole life cost and value of the assets understood (assessed in both accounting and Market Value terms, especially where an accounting loss or 'impairment' might arise)?
- Has the accounting treatment of any land and property transfer into the JV been considered when assessing the affordability of the JV?

6.9 In exceptional circumstances VfM may be better served by transferring assets at less than the expected best price achievable, however the off-setting benefits must be clearly quantifiable, e.g. the delivery of regeneration or economic benefits in areas of market failure. The sale or lease of an asset at less than Market Value to the JV is likely to constitute a 'gift' requiring

⁵⁴ OGC *Guide for the disposal of surplus property*, November 2005.

⁵⁵ HM Treasury *Green Book Appraisal and Evaluation in Central Government*.

notification to Parliament⁵⁶ and consent from the Secretary of State. Local authorities should be aware of the provisions of the Local Government Act 1972: General Disposal Consent 2003⁵⁷ which in certain circumstances provides for the removal of ministerial consents where the “undervalue” is less than two million pounds.

6.10 Disposing of land at less than its Market Value may also give rise to State Aid issues (see Chapter 3). This applies both to any initial transfer to the JV and subsequent transactions, e.g. on exit or termination.

Example 7: Alternative approaches to exploiting property through a JV

One NorthEast ‘Buildings for Business’ – transfer of surplus investment properties

In April 2004 a new limited partnership entity (Buildings for Business) was formed between UK Land Estates and the North East regional development agency, ONE NorthEast. The partnership had an extensive property portfolio comprising some 1,500 industrial properties on 22 estates. ONE NorthEast established the partnership with UK Land Estates to bring in private sector expertise to running the properties. As well as managing the properties, UK Land Estates has a 50% share in the deadlocked limited partnership. The partnership holds and manages the investment portfolio, which was 100% transferred into the JV, and through disposals will inject substantial resources to regenerate the properties and estates, providing high quality business accommodation throughout the region. In return for contributing its assets ONE NorthEast receives an interest bearing loan note from the JV as security equivalent to the book value of the assets. Additionally the private sector participant’s equity is effectively locked up through a second loan note arrangement as further security.

(Source: ONE NorthEast)

British Waterways ISIS – contribution of development land through options

ISIS is a waterside regeneration company formed in October 2002 by British Waterways with Igloo (the regeneration fund of Morley Fund Management) and AMEC Developments (now MUSE Developments). British Waterways already had considerable success in the regeneration of its urban and rural waterways, forming site-specific JVs to unlock the value of its land. ISIS built on the successes of these ventures, however, unlike them it took a nationwide, multi-site approach, focusing on major waterside developments across the UK. Initially, the ISIS limited partnership JV had options on ten British Waterways sites supplemented by a pipeline of additional British Waterways and third party land as opportunities arise. A VfM mechanism and detailed investment criteria for transferring assets into the JV were established within the JV Agreements.

(Source: British Waterways)

Asset-backed JVs in the public sector

6.11 Where an asset, particularly land and property, has further development potential it may be better VfM to enter into a JV rather than simply dispose of the assets on the open market. Contractual property development JVs are relatively common in the public sector, particularly with local authorities, and likely to be the preferred approach for most straightforward single project scenarios where a partnership with the private sector is desirable.

6.12 The creation of a JV with the private sector may be preferable for more complex scenarios or where a portfolio of assets is involved. Box 6.B sets out the reasons why a public sector body might contemplate the creation of such an entity with the private sector.

⁵⁶ See *Managing Public Money*, Annex 4.12 Gifts.

⁵⁷ Circular 06/03: Local Government Act 1972 general disposal consent (England) 2003 disposal of land for less than the best consideration that can reasonably be obtained.

Box 6.B: When to consider exploitation of property assets through a JV

JV may be desirable where:

- there are complex land assembly or planning issues involved, possibly resulting in market failure;
- a marriage value opportunity exists by combining the public sector land with one or several private sector landowners;
- wider economic or social benefits can be delivered by maintaining a greater degree of public sector control over the future use of the assets;
- the value of assets can be captured and used as security to raise finance for investment in new infrastructure or buildings; and
- delivery of wider benefits could be achieved by bundling together a coherent package of assets facilitating cross subsidy of profitable and sub-optimal developments.

JV may not be appropriate where:

- the decision to use a JV entity is driven by classification or accounting issues i.e. the underlying transaction is a straightforward sale and leaseback of the assets with no additional benefits.

Intellectual property rights (“IPR”)

6.13 Intellectual Property Rights (IPR) are rights that exist to protect certain works from unauthorised use by others. Further details on the nature of IPR and procedures for dealing with IPR issues can be found in Annex F.

6.14 There are two methods of contributing IPR to a JV:

- a licence agreement on arm’s length terms (as it may continue beyond the owner’s equity interest in the JV); or
- an assignment of the ownership of the IPR to the JV.

6.15 Table 6.A below identifies possible differences between a licence and an assignment.

6.16 The public sector body will also need to clarify in the JVA and/or IPR subsidiary contracts the position in relation to new IPRs created in the future by either the JV, the public sector body or any of the JV partners in connection with the JV. This is also dealt with in more detail in Annex F.

Table 6.A: Possible differences between Licences and Assignments

| | Licence | Assignment |
|---------------------------|--|--|
| Ownership of existing IPR | Remains with the licensor. | Is transferred to the JV: consider whether a licence back to original owner will be required. |
| Payment | Licence fee or royalty stream (potentially convertible into equity) will need to be on arm's length basis and will reflect the nature of the JV. | One-off lump sum or in exchange for an equity stake in the JV. |
| Protections | Cost of protecting and enforcing the IP generally remains with the licensor/owner (although for an exclusive licence these costs could be assigned to the licensee). | Cost of protecting and enforcing the IP transferred to the JV. |
| Termination | Termination provisions giving the licensor a right to terminate the licence usually included. | Rights may or may not revert back to the original contributing party depending upon the terms of the JV Agreement. |
| Restrictions/control | Licence can include certain restrictions in order for the licensor to control use of existing IP. | As owner of the existing IP, the assignee will have the rights of an owner. |
| Warranties | The JV should seek warranties in relation to ownership of the IPRs which are the subject of the licence. | The JV should seek warranties in relation to ownership of IPRs and transfer of IPR to the JV. |
| Duration | Usually limited. | Assignment of ownership is usually permanent, unless otherwise specified. |

Staff issues

6.17 The JV partners will need to determine how the JV is to be staffed and by whom. Often it is important to the success of the JV business that particular employees employed by one or other of the JV partners, who have in-depth knowledge of the asset or a specific expertise, continue to provide this knowledge and expertise to the JV. Where particular skills are needed which cannot be provided by the parties, the JV will need to recruit from the market place.

6.18 The potential for concerns about propriety and conflict of interest can come to the fore when public sector employees lead 'buy-outs' of entities from public sector bodies (see also Chapter 3 and Chapter 10). If there is the potential for such concerns this will highlight the importance of adequate procedures for the independent assessment of asset valuations, remuneration policies, etc.

6.19 Careful consideration should be given to the appointment of any employees of the public sector body as executive directors of the JV or as designated members (for administrative purposes) of a LLP. Different considerations apply where a LP structure is adopted (with the general partner being responsible for the management of the LP and the other partners not taking management responsibility). It is not uncommon for employees of each participant to be nominated as directors of the JV. The role and duties of directors of a JV company need to be understood by the individual taking up the directorship (or equivalent under a LLP). These issues are further set out in Chapter 10.

6.20 Staffing issues associated with the establishment of a JV can be complicated and Public sector bodies should seek formal independent advice from employment specialists or from an employment lawyer at an early stage.

Staff transfers

6.21 There are several methods available to transfer skills or employees to the JV, depending upon the particular circumstances to be settled such as the length of secondment or unpaid leave arrangements and provisions for their continuation. Available methods include:

- automatic transfer under the Transfer of Undertaking (Protection of Employment) Regulations 2006 (the “TUPE Regulations”);
- resignation from current employer and re-employment by the JV;
- secondment to the JV; and
- others, such as the provision of the required skills under a consultancy contract.

6.22 If the existing expertise of individuals employed by the JV participants is only required for a limited time (e.g., whilst new staff employed by the JV learn the requisite skills), secondment is usually appropriate.

6.23 Where it is identified that certain employees should work for the JV further decisions need to be made, in particular whether TUPE would apply if an existing undertaking or function were to be transferred from a JV party into the JV⁵⁸, and if so the scope of staff who could claim attachment to the work transferring to the JV. Having considered the scope, consideration should then be given to the following:

- are the right staff transferring?
- do staff want to transfer?
- are there incentives for staff to transfer?
- what is the most appropriate route?
- what happens to the pensions of the staff transferring?
- what happens to staff at the end of the JV?

6.24 Where TUPE applies the public sector body is obliged to consult with staff and trade unions at the earliest opportunity. The JV participants will also need to consider the possible implications of operating different employment terms and conditions inherited from the respective public sector and private sector participants, and the likelihood of a two-tier system.

Incentives for staff

6.25 The combination of people, skills and networks is usually a key driver for forming a JV, however, it leads to a number of complexities. Thought needs to be given to the incentives which a particular approach might lead to – individuals sourced from either the public or private sector may have split loyalties as between their existing allegiances and longer-term career progression.

6.26 Contracts with the private sector participant for provision of JV staff should be structured and priced carefully to avoid or minimise potential conflict between the desire to drive through ongoing efficiencies in the JV and the desire for the private sector participant to retain revenue streams under the staff resource contract.

6.27 Incentives can be offered to encourage staff to transfer, however, consideration will need to be given to the potential conflicts of interest this might introduce.⁵⁹

6.28 An important incentive may come in the form of an equity stake in the new entity for key members of staff. The rules governing civil servants have been clarified in order to facilitate civil

⁵⁸ See also ODPM Publication Employment and Partnerships – Technical Notes (ODPM 2003 updated by DCLG 2006. See Cabinet Office Code 2005 and also, for local authorities, the Code of Practice in Workforce Matters ODPM Circular 3/03 Annex D.

⁵⁹ For Public Sector Research Establishments see Good Practice for Public Sector Research Establishments on Staff Incentives and the Management of Conflicts of Interest, Office of Science and Technology. Available from the BIS website: www.BIS.gov.uk/files/file12076.pdf.

servants taking equity shares in companies where appropriate.⁶⁰ This can be particularly relevant when there is a transfer of technology in which staff have been centrally involved.

Pensions

6.29 Pensions are often an important element in the overall remuneration of staff in the public sector, and the public sector occupational pension schemes can offer high quality benefits. Not all private sector pension schemes are commensurate with the public service schemes. The JV must however offer a broadly comparable pension scheme or continued access to the public services scheme as relevant. Specialist advice should be sought where any staff are transferred into the JV.

6.30 Guidance on pensions for staff transferring from the public to the private sector is given in several documents.⁶¹

⁶⁰ See paragraph 4.3.8 of the Civil Service Management Code.

⁶¹ Staff Transfers in the Public Sector - Statement of Practice, www.hm-treasury.gov.uk/d/staff_transfers_145.pdf. Assessment of Broad Comparability of Pension Rights, Statement of Practice by the Government Actuary, www.hm-treasury.gov.uk/d/staff_transfers_145.pdf page 18. Staff Transfers From Central Government: A Fair Deal for Staff Pensions. Guidance to Departments and Agencies, www.hm-treasury.gov.uk/d/staff_transfers_145.pdf.

7

Funding, fees, charges and tax

In order to operate, expand and develop as a flexible operation, the JV will require sufficient funding. The timing, amount and origin of this funding will depend on the operation, nature and structure of the JV.

This Chapter:

- considers options for funding the JV;
- summarises policy and legal constraints on the JV's commercial conduct and in particular how it charges for its products and services; and
- lists a number of tax issues which can be relevant to the formation and operation of JVs.

Sources of funds

7.1 For JVs classified to the public sector (i.e. public corporations and self-financing public corporations), it would normally be expected that the required finance would be provided by the private sector. Careful consideration is needed in these circumstances (see also Chapter 5 on the implications of public/private classification). Because Government is able to borrow more cheaply than the private sector, the *prima facie* argument is that any private sector borrowing can only offer VfM if the private sector debt provider is bearing genuine risk.

7.2 Depending on the purposes of the JV, it may be necessary to ensure that a public sector classified JV does not obtain a commercial advantage through public sector financing at below the commercial market rate for risks involved; this could constitute State Aid (see Chapter 3 and Annex C). This risk may be mitigated where Government lending is structured so that it is effectively provided to the JV at a prevailing market rate.

7.3 As set out in Chapter 3, public sector bodies should first ensure they have the necessary statutory powers, authority and if required budgetary cover to participate in a JV or become exposed to future potential liabilities, for instance, through indemnities. The VfM aspect is key and can be considered in terms of providing a reasonable return for a given investment, taking into account the risks associated with a given capitalisation structure.

7.4 This is an area where professional advice should be sought. This Chapter 7 only provides a brief overview.

7.5 Funds for the JV can be raised in a number of ways, at both initial funding stage and subsequent rounds of funding. These include:

- issue of shares (equity) or partnership interests;
- debt raising; and
- grants.

7.6 The JV can raise funding by any combination of these three means, both when it is formed and in subsequent fund raising. At formation the risks are inherently greater as the JV has no

track record, and so funding at this stage will typically come from the JV's founders unless debt can be secured against the JVs assets, e.g. in the case of a property JV.

7.7 The introduction of the Prudential Framework for Capital Investment by Part I of the Local Government Act 2003 provides a further source of finance to local authorities⁶².

Issue of shares (equity)/partnership interests

7.8 This is the issuing and/or selling of shares in order to raise funds. These shares can be of many classes (different types with different rights), and can include voting and non-voting shares (see Chapter 8). The principal sources of equity funds are:

- founding participants;
- venture capitalists/private equity funds, including through trade sales; and
- the capital markets through flotation and a public listing.

7.9 The use of an LLP or LP structure allows for capital investment by founding participants on the formation of the JV and also provides a vehicle in which venture capitalist/private equity investors would be prepared to invest. However, because an LLP is not able to issue equity securities generally to the public, it would not normally be suitable for a flotation or listing on capital markets and, in that regard, offers less flexibility than a traditional company limited by shares or guarantee.

7.10 It is common for initial equity funding to be provided by the participants. For many JVs, the private sector participant may be expected to fund initial equity (with the public sector body participant providing other assets). For 'route to market' JVs, typically, equity funding will be provided by the founding participants in the early stages of the JV's existence (such as the initial funding round), however later the involvement of venture capitalists or private equity funds may be required.

7.11 When additional shares are issued, it is important to consider the implications, particularly with respect to dilution of the public sector interest (see example 8 below).

Founding partner as a source of equity funding

7.12 When the JV is formed, the private sector participant will typically commit to provide funding in return for an interest in the JV. Funding commitments may be in the form of partly paid shares, or commitment to subscribe for further shares or partnership equity, or a commitment to provide shareholder or partnership loans. It is important to ensure that this funding commitment is sufficient for the JV's initial needs, that the private sector participant is credit worthy and that funding is assured; a guarantee or other collateral (such as a bank letter of credit) for committed but unpaid funding should be sought.

⁶² See also guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

Example 8 : MRC JV dilution of shareholding

RiboTargets Ltd was established in July 1997 as a spin-out company from the Medical Research Council's (MRC) Laboratory of Molecular Biology (LMB) in Cambridge. The company raised £7m from four investors (Apax Partners, Advent International, 3i, and Kargoe). In return for the MRC's Intellectual Property, know-how and limited use of specified facilities at LMB, the MRC took a 10% shareholding in RiboTargets and a seat on the Board of Directors.

In a subsequent round of financing some 36 months later, £6m was raised from the same set of investors plus Rendex, NIB, and Quester. The MRC, who because of their charter were unable to invest at subsequent rounds, were consequently diluted by approximately 50%. After this second financing and as a result of the MRC's continued support for the company and input at the Board level, the MRC director was asked if he would wish to continue on the board, which he did for a further 6 months.

In 2001 the company raised a third round of finance to underpin a significant expansion in its development plans and research programmes. The MRC's shareholding was further diluted; however the net worth of these shares continues to increase as the company's market capital and share price continues to climb. This long-term strategy has served MRC well.

Another example is the MRC's holding in Cambridge Antibody Technology (CAT). In the early 1990s MRC held founding equity in CAT in return for defined IP. In subsequent funding rounds the MRC holding was diluted; however MRC later invested additional technology in CAT in return for further shares. Since the flotation of the company, MRC has sold parts of its shareholding at different times to raise around £10m. In this example the public sector body was able to invest further technology at a later stage in the company's development and benefit by reducing the dilution effect on its shareholding.

Source: Partnerships UK, Medical Research Council, RiboTargets Ltd

Capital markets through flotation and public listing

7.13 A flotation on the capital markets is able to provide larger injections of equity funding than is usually possible through any other means. The transaction will, however, require significant external financial and legal advice and this is only therefore likely to be an attractive option if the JV is a company of substantial size and has an established track record. There are many issues to be considered before an entity can raise money in this way, in particular: the diversion of key management time during the fund raising process and afterwards; the costs of compliance with stock exchange rules; and the consequences of share price fluctuations on staff morale and trading participants. Some relevant guidance can be found in HM Treasury guidance for public sector bodies conducting flotations.⁶³

Debt raising

7.14 Loans from existing participants are more likely in the JV's early stages or at initial funding; loans from banks become more likely as the JV grows or where it is possible to leverage against property or income generating assets. The possibility of the JV raising funds through bonds will only arise when the JV has reached a very substantial size because of minimum size-of-issue constraints.

7.15 Local authorities may also consider raising funds through the prudential borrowing regime. Local authorities will need to consider whether any financial assistance provided to the JV can be afforded through future revenues and should factor in their prudential borrowing limit.

⁶³ HM Treasury *Getting best value from flotations*, November 2000. www.archive.treasury.gov.uk/pep/flotation.pdf.

7.16 Public sector bodies should consult with their sponsor bodies and where appropriate the relevant HM Treasury spending team to ensure they have the necessary powers and resources to make loans to the JV and/or to understand the impact of third party debt raised by the JV on the public sector body's accounting and budgetary position (see also Chapter 5).

Loans from participants

7.17 It is often possible to agree that capital injection by the participants is in the form of a loan rather than through the issue of shares. The advantages of including some loans rather than pure shareholder or partnership equity include:

- interest and (if scheduled in detail) repayment of loan principal can provide a predetermined and clearly documented flow of cash back to the participants (if the cash is available);
- that they can be more tax-efficient; and
- that they are capable of being secured against the assets of the JV.

7.18 In the company context debt can be repaid even if there are little, or no, accounting profits as repayments of debt are not made out of distributable reserves. Partnership structures can provide more flexibility for returns on capital.

7.19 The servicing of a loan will typically have a priority call on the JV's financial resources, ahead of distributions of profits (depending on the details of the loan and shareholder/partnership documentation) so it is a less risky form of investment. Clearly, if an investment is agreed to be less risky it will typically attract a lower return. If the parties have different profiles of equity vs. loan investment this will inform the wider financial evaluation and negotiation processes.

7.20 As with external debt, participant loans will require appropriate internal procedures to ensure repayment obligations are adequately monitored and discharged.

Loans from commercial lenders

7.21 The JV may want to arrange a loan from standard commercial lenders (e.g. banks). This is usually only possible when the JV can offer security for the loan or has a track record of generating profits. If there is still considerable commercial risk, the lender may require a guarantee from the JV's founding participants. In normal circumstances the public sector body should avoid giving such guarantees however this will be considered on a case by case basis according to the corporate policy of the public sector body.

Issuing of bonds or other transferable loan stock

7.22 Corporate bonds can be issued which pay out a certain interest rate/return at a given time. As with flotations and public listing the use of corporate bonds would normally require a JV of substantial size and a requirement for significant external finance. The value of the bonds can be paid back using various payment profiles. Most of the previous points raised in this Chapter apply equally to corporate bonds. In addition consideration would need to be given to the 'rating' of the bond, potential pre-payment penalties in the event of refinancing or repayment and other indirect impacts on flexibility, exit arrangements, classification and accounting treatment.

Grants

7.23 It is sometimes possible to attract grant funding for a venture. The notional or financial return requirement against grant will usually be related to outputs or outcomes with clawback

in certain circumstances. Grants are usually only available for specific purposes, such as for R&D expenditure or investments in economically deprived areas and many grant schemes are only open to certain types of entity, such as Small and Medium Enterprises (SMEs). The eligibility of a JV for certain grant schemes will also depend on whether it is classified in the public or private sector (see Chapter 5) and there may be other more specific eligibility criteria.

Fees and Charges

7.24 The principles on which public sector bodies should set prices for goods and services are set out in Chapter 6 of HM Treasury's *Managing Public Money*⁶⁴ and possible legal restrictions such as those contained in the Competition Act 1998. The guidance will not formally apply to the JV if it is classified to the private sector but should still be applied in principle given the public sector's role in the JV.

7.25 Fees and charges should normally be set to recover the full cost of the service, while recognising that in some cases, e.g. some prescription charges and university fees, that may not be appropriate either for policy reasons or because the relevant legislation does not permit it (e.g. tax elements, commercial charging).

7.26 Some services are discretionary. Services of this kind are often supplied into competitive markets, though sometimes the public sector supplier has a monopoly or other natural advantage. For these services, the charges should be set at a commercial rate, albeit consistent with the fees and charges guidance set out above, including delivering a proper return on the use of resources acquired with public funds.

7.27 Besides the issue of fees and charges by the JV to the outside world, public sector bodies should also consider carefully arrangements by which the JV pays fees and charges to its sponsors (or, for that matter, arrangements by which the JV charges fees to its sponsors). These might include management fees or payments for facilities or services. This is a complex area and transparency will be required on all agreements to ensure that they are properly reflected in the overall evaluation of the proposed JV. The simplest approach is to ensure that payments and terms are consistent with what would be agreed on an arm's length basis. This is to avoid participants drawing out profits from contractual arrangements and upsetting the intended allocation of risks and rewards.

Tax issues

7.28 The JV and its advisers will need to consider numerous tax issues, concerning both direct and indirect taxation. A number of these are listed below. The tax implications of setting up a JV should be carefully thought through.⁶⁵ The type of JV used will be important both for the commercial viability of the entity established and for attracting private sector investment and care should therefore be taken, with tax advice as appropriate, to ensure any tax aspects are understood at an early stage. Annex G lists a number of direct tax issues affecting a JV and provides a comparison between corporate JVs and those constituted as partnerships.

7.29 Tax issues go well beyond the fairly straightforward differences between the corporation tax arrangements as between companies and unincorporated vehicles. Other issues include the complexities of VAT exposure and stamp duty arrangements where significant property assets are involved. Tax considerations, however, should not affect the aims and objectives of the JV

⁶⁴ www.hm-treasury.gov.uk/d/mpm_whole.pdf.

⁶⁵ There will be, e.g., differing tax implications for a JV company compared to other options such as in-house, or a contractual relationship with the private sector.

and it is crucial that arrangements made are both practical and credible. Reference should also be made to the guidance issued by the HM Treasury Office of Accounts Team.⁶⁶

Direct tax issues

7.30 The commentary in Annex G is restricted to vehicles that will be UK tax resident. The commentary also assumes, for simplicity, that private sector investment will solely come from corporate entities.

7.31 It should be noted at the outset that many public sector bodies are not subject to direct tax and that this may influence the choice of JV used.

Indirect tax issues – VAT

7.32 Public sector bodies have varying VAT treatments, depending on whether, e.g., they are central departments or NDPBs. These treatments will not apply to a JV, regardless of whether it is classified to the public or private sector.

7.33 The JV may need to register for VAT in its own right or through, e.g., a General Partner in the case of a Limited Partnership. Other issues for the JV that need to be considered are:

- the VAT liability of supplies made;
- VAT recovery on expenditure; and
- the impact of any JV agreement on the partial exemption calculation of the public sector shareholder/partner.

7.34 The VAT treatment of transfers to a JV should also be considered. The transfers may constitute supplies for VAT purposes or may qualify as VAT-free transfers of a going concern (TOGC) depending upon the precise nature of what is being transferred.

Indirect tax issues – Stamp Taxes

7.35 The transfer of UK real estate or UK shares into a JV could give rise to stamp duty land tax or stamp duty respectively. The transfer of shares or interests in the JV could also give rise to UK stamp taxes – it should be noted that treatment can be different depending on whether a corporate or LLP/LP vehicle is used and specialist advice should be taken where relevant. Statutory relief may minimise any potential liability and these should be carefully considered early in the process of determining the JV's structure and in drafting documentation.

⁶⁶ www.hm-treasury.gov.uk/psr_index.htm examples include DAO 08/03 "Tax Planning and Avoidance" and DAO06/00 "Use of external tax advice by government departments" if relevant. Note that these letters are incorporated into Managing Public Money 4.2.6 and Anne 4.4 para 16.

8

Structuring the joint venture equity

Chapter 8 describes some of the decisions that a public sector body needs to make in establishing the JV and its business, to help ensure that the structure fulfils the public sector body's objectives and offers a deliverable commercial solution. In particular it covers:

- the Joint Venture agreement;
- types of equity participation;
- distribution policy;
- potential deadlock and general dispute resolution procedures;
- strategies and controls for the participants to exit the JV entity; and
- commercial insurance.

The issues set out below apply equally to companies and partnerships.

The Joint Venture agreement

8.1 A JV participant may express its intention to provide certain assets or funds to the JV, but there will be no binding commitment to do so unless an agreement is entered into. The JV agreement is a contract and is governed by the ordinary rules of contract. Accordingly a participant (even a participant with the majority voting rights) cannot unilaterally amend the terms of the JV agreement. Unlike the constitutional documents the JV agreement is usually not a public document but some details may be the subject of a request under the Freedom of Information Act (FOIA) 2000⁶⁷ dependent on the context.

8.2 During the private sector partner selection process, the public sector body and its advisers should prepare either a summary of the key terms of the JV agreement or a draft of the JV agreement for circulation to potential participants. This is a key part of the public sector body's consideration of how it believes its desired outcomes can be achieved. In discussions/negotiations with potential participants, however, these draft documents may change and the public sector body should be flexible in its approach while ensuring it secures its requirements.

8.3 The types of commitments which the public sector body should seek from its JV partners, and set out within the JV agreement, are set out in Box 8.A below.

8.4 Note that if the parties wish the JV to be classified to the private sector, it is important that control of the JV is not inadvertently passed back to the public sector through excessive and restrictive veto rights or other obligations included in the JV agreement (see Chapter 5).

⁶⁷ Model FOIA clauses are available from the OGC www.ogc.gov.uk/documents/Model_FOIA_confidentiality_clauses.doc.

Box 8.A: Typical contents and commitments to be set out in the JV agreement

- Details of the parties and the Board (partnership) constitution
- The initial subscriptions for equity of each JV partner or other funding obligations
- Purpose and objectives for the JV including services, scope of business and performance
- Business plan (and the requirement to prepare a business plan and budget each year)
- Key commercial terms and conditions precedent, including inter alia:
 - definitions of assets, liabilities, contracts transferring or not transferring
 - obligation of the parties to execute any subsidiary contracts
 - any non-compete/conflict of interest provisions and obligations of confidentiality
 - IP and ownerships rights
 - funding obligations including each parties intention for future funding commitments
 - guarantees, warranties and indemnities
 - distribution policy
 - restrictions on competing activity
 - termination, dispute resolution and other material issues
 - management and operational issues generally
 - deadlock provisions, veto rights and delegations of authority
- Staffing and TUPE issues
- Exit strategies and valuation
- Obligations of transparency (e.g. access to charging information of private sector partner under secondment agreements or as required for public sector auditing purposes)
- Governing law and jurisdiction

Types of equity participation

8.5 A subscription for ordinary equity shares or partnership capital is the simplest and most common way to capitalise a JV. This subscription can be in the form of a capital or non-cash (assets, IP etc) consideration. The law of England and Wales provides a flexible system in which various types of shares can be issued with different rights associated with them. Shares of the same type are referred to as a “class”.

8.6 Different classes of ordinary shares with differentiated rights and restrictions can be used to protect the interests of the public sector body, particularly where it is a minority participant, subject to the restriction on “golden shares” (see Annex D “Special Shares” for further explanation). The extent of control on the JV exerted through such class rights may affect its classification. A class of ordinary shares may carry the right to appoint a designated number of directors/administrators to the board and/or a right of veto or approval over certain matters which must be decided by the shareholders.

8.7 Partnerships have partnership capital. As with companies, partnership capital can be purchased using cash or non-cash assets. Partnership capital can be divided into different classes with differing rights in respect of distributions of the partnership’s profits and capital. The rights attaching to each class of capital will be set out in the JV Agreement.

Percentage allocation of equity interest

8.8 The size of the public sector body's participation in the JV will be a key issue which must be considered at an early stage. It is imperative that each participant's equity holding is justified by the value of assets (whether cash or non-cash) which it is contributing.

Distribution policy

8.9 The participants will need to decide a general policy for how any available profits of the JV are to be distributed (assuming that the JV entity is intended to be able to distribute profits). The JV agreement should include a provision setting out the principles of the distribution policy.

8.10 As distribution policies can be expressed in a number of different permutations, advice should normally be sought from legal and financial advisers. Examples include:

- a requirement to distribute no less than X % of the realised profits each financial year;
- a requirement to distribute all profits in excess of working capital requirements as specified in an agreed budget or business plan;
- a requirement that no profits are to be distributed until a certain event occurs; and
- a distribution 'holiday' while the JV business gets established.

8.11 Investors in partnerships (including JVs) can get back their capital more easily than in corporate entities since the company rules on distributable profit/reserves do not apply.

8.12 In the specific case of distribution of surpluses from 50:50 JVs where the public sector partner is a Trading Fund, guidance has been issued by HM Treasury.⁶⁸

Decision making

8.13 Decision-making in the JV requires careful consideration. Decision-making mechanisms need to allow the public sector body sufficient control (classification considerations are relevant to this) whilst allowing for efficient operation of the JV (see also Chapter 10).

8.14 In a company, the Companies Act, the company's memorandum and articles of association and/or the shareholders agreement identify how decisions are made both at shareholder and director level. In an LLP or LP decisions of partners and/or management are set out in the partnership agreement.

Deadlock

8.15 In a JV, deadlock can arise at board level (e.g. where opposing positions are taken by an equal number of directors and there is no casting vote) or at the participants' level (where participants fail to agree those matters which have been reserved to them). The JV agreement can provide for deadlock disputes to be escalated to senior individuals in the participants' parent organisations (e.g. to the chief executive of the private sector company and the Permanent Secretary of a Department).

8.16 However, some disputes may result in an intractable deadlock where there is a fundamental breakdown in management and inability to continue with the JV. It is usual to include in the JV agreement mechanisms for avoiding deadlock (e.g. referring disputes to an

⁶⁸ *Guide to the establishment and operation of Trading Funds* HM Treasury Central Accountancy Team, January 2001. Available from the HM Treasury website: www.hm-treasury.gov.uk/d/Guide_to_the_Establishment_and_Operation_of_Trading_Funds.pdf.

expert) and the consequences of an intractable deadlock. The participants will know the consequences of failing to resolve a deadlock and this knowledge may help disputing parties to focus their minds on trying to resolve the disputes. Types of provisions for when a deadlock becomes intractable include:

- winding up of the JV; or
- some form of buyout mechanism leading to one party buying out the other e.g. so-called sealed bids, Russian roulette clauses, etc.

8.17 It is possible for the contractual documents to be silent as to the consequences of an intractable deadlock; in effect this may mean that the only documented route to follow in that case would be an exit at the instigation of one party or other. The participants will then have to agree a procedure when it occurs (or move straight to exit). This can lead to protracted disputes as there is no time frame or mechanism for resolution of the deadlock issue and this may have a detrimental effect on the JV's ongoing business. This approach is strongly discouraged. If the parties are sufficiently confident about the proposition to enter into the JV in the first place, they should understand the potential for disputes and be clear about what they would want to happen in the event of disputes. If they have that clarity it will be appropriate to document agreed procedure and it is unlikely that immediate recourse to exit from the arrangement will be the preferred strategy.

Exit strategies

Exit provisions

8.18 Exit provisions are needed to enable participants to realise their investment in the JV (and thereby extract value), and to protect their investment when other participants wish to exit or if the JV or other participants fail to perform their respective obligations or act in accordance with the agreed objectives.

8.19 Agreeing provisions for participants to exit from the JV is likely to be one of the most difficult issues to resolve. This stems from the difficulty in determining the value of equity participations held in the JV where they have no readily established market value. It is important to ensure that the public sector body avoids the situation where it is forced to buy shares, unless appropriate, or to buy at an inflated value. This is a complex area, but typical mechanisms for calculating the value of participations include:

- net present value of future earnings;
- underlying asset value, e.g. calculated on the basis of depreciated replacement costs or net book value;
- break-up value; and
- the use of an expert valuer.

8.20 It will be important to draft appropriate provisions in the JV agreement from the outset setting out when and how participations in the JV can be sold and the JV wound up, taking account of the consequences of these actions. Before attempting to draft such provisions, the parties must be clear of the underlying intention behind setting up the JV, i.e. what are the objectives of the parties in setting up the JV? How are these objectives to be realised? The following questions will need to be considered:

- To what extent can the JV exist without the founders' involvement?
- Is the JV being set up for a specific task or duration, so that when it is completed or reached the JV will cease to operate?

- Does any participant intend to sell its interest when the JV's business achieves a certain milestone and, if so, is it expected that this party would sell to a founder or a third party?
- In what other circumstances would changes to the participants be permitted?
- How are management deadlocks or disputes to be resolved?
- In what situations would changes to the participants be required?

Exit Scenarios

8.21 There are two basic scenarios for a participant to exit the JV:

- *Voluntary* – either voluntary sale of the holder's interest in the JV or where all the participants consent to winding up the JV.
- *Compulsory* – events which compulsorily give rise to either a sale of a holder's interest or winding up of the JV.

8.22 Further information on the exiting strategies can be found in Annex H.

Sale of JV shares

8.23 A sale of an equity interest will alter the ownership structure of the JV, but the JV and its business will continue. In some cases this may result in a change in the classification of the JV.

8.24 Where a participant sells its participation in the JV and exits the JV agreement, parties will need to consider:

- what will happen to any assets or shared assets contributed to the JV by the outgoing participant (including future use of IPR rights);
- how a price for the participation will be determined;
- what process will be used for approval of new participants;
- what will happen to any loans provided to the JV by the outgoing participant;
- how to deal with any guarantees or indemnities provided by the outgoing participant;
- ONS classification and other regulatory approvals, e.g., licences, permits, etc.;
- the extent to which the outgoing participant should be bound by obligations of confidentiality or restrictive covenants;
- what will happen to any staff who have been seconded to the JV from the outgoing participant; and
- what will happen to any subsidiary contracts between the outgoing participant and the JV.

8.25 In circumstances where the JV is wound up (voluntarily or compulsorily), different considerations need to be addressed, in particular, what will happen to the assets owned by the JV and staff issues (see also Chapter 6). How the assets are to be distributed will depend upon the reason for the winding up. Under a default or deadlock scenario, the JV agreement should stipulate how assets are to be dealt with.

8.26 Specific mechanisms related to the sale of JV shares are set out in Annex I.

Commercial insurance

8.27 The JV will be responsible for taking out appropriate insurance to cover its activities.

8.28 Managing Public Money (Annex 4.5) highlights that although public sector bodies do not generally take out commercial insurance, doing so may be justified in wider markets initiatives. This is because these activities are outside the government's core responsibilities and losses on a department's discretionary commercial activities could reduce resources available for its core activities. It will usually therefore make sense to insure them, so far as cover is available on a cost effective basis. Any goods or services sold to other parts of central government should not, however, be insured.

8.29 A public sector body should seek advice on the appropriate commercial insurances available to protect it against the potential liabilities which could arise from setting up and operating the JV.

8.30 If the JV carries out business or has registered overseas (e.g. such as the USA), liability issues will need thorough examination. A possible route to insulate the public sector body from unforeseen liabilities originating in overseas jurisdictions could be to route its interests in such a JV through a limited liability holding company designed to act as a firewall⁶⁹.

8.31 Action should be taken to reduce any insured risks and liabilities, e.g. by ensuring that obligations are clearly defined and that there is sound evidence to back any claims the public sector makes about the assets it is contributing to the JV. Nevertheless, the JV or the private sector participant(s) may bring a claim against the public sector body, e.g.:

- for breach of any of its obligations under the JV agreement;
- for breach of any of its obligations under a licence or concession agreement entered into with the private sector participant;
- for breach of any warranty, e.g. relating to ownership of any asset transferred or licensed to the; or
- for a misrepresentation as to the extent and viability of the market for the JV's activities.

8.32 Where a director or officer is also employed by the public sector body, insurance should be taken out in relation to their liabilities as a director or officer.

⁶⁹ At the time of writing there is no specific guidance however the extra risks of operating abroad should be considered in line with the approach to risk set out in *Managing Public Money*.

9

Selection of the private sector partner

Chapters 5 to 8 set out some of the commercial and legal issues to be considered in developing the framework for the JV, once the public sector body has decided that a JV is the best VfM option. Public sector bodies will then have to choose how to select their partner and what process to use for selection.

The process of selecting a partner will need to be tailored to meet the business objectives of the JV and will depend on the nature of the project. For a JV to be successful it will need to be a genuine partnership between the public and private sector participants and so the process of selecting a partner will involve negotiations to set commonly agreed objectives and goals.

In setting up the JV the public sector body will itself need to consider putting together the right team to manage the process and the support that it will need to do this effectively.

This Chapter addresses:

- the need to ensure selection complies with relevant policy and legal requirements;
- the practical steps to be taken to select a partner;
- the use of selection criteria to evaluate potential partners;
- development and evaluation of the JV business plan;
- how confidentiality agreements may be used during the selection process;
- decisions on the governing law and jurisdiction for the JV, and
- the application of competition law.

Policy and legal requirements

9.1 A public sector body seeking to select a private sector partner for a JV will need to determine whether the legal requirements of the EU public procurement rules⁷⁰ as interpreted in UK law apply, in addition to the impact of the government's VfM policy upon its proposed selection or competition strategy (see Chapter 4).

EU public procurement rules

9.2 The EU public procurement rules make particular requirements of public sector bodies which are "contracting authorities"⁷¹ and which establish corporate JV bodies, and/or confer contracts for services, works or supplies (goods). This applies equally to JVs established as partnerships. Account needs to be taken of this in structuring the selection process for the JV partner.

9.3 Even where there is no strict requirement to apply the EU rules to the selection of a partner the principles derived from the EU treaties⁷² may still apply. Where these principles apply, advertising and running a competition for the selection of the partner is likely to be required.

⁷⁰ EC Directive 2004/18/EC; the Public Contracts Regulations 2006 (England, Wales and Northern Ireland); the Public Contracts (Scotland) Regulations 2006 (Scotland).

⁷¹ The Office of Government Commerce (OGC) publishes best practice guidelines on procurement-related issues (www.ogc.gov.uk/procurement.asp).

⁷² The five principles are: non-discrimination, transparency, equal treatment, mutual recognition and proportionality.

Reference should be made to the Commission Interpretative Communication on the application of Community law on Public Procurement and Concessions to Institutionalised Public-Private Partnerships (IPPP)⁷³. IPPPs are understood by the Commission to be a cooperation between public and private parties involving the establishment of a mixed capital entity which performs public contracts or concessions, and the private input to the IPPP consists – apart from the contribution of capital or other assets – in the active participation in the operation of the contracts awarded to the entity or the management of the entity⁷⁴.

9.4 In considering the procurement issues specific points to note include:

- even if the establishment of a JV does not involve the provision of services, works or supplies which are strictly subject to the EU rules, some sort of advertising and competition may still be required for the selection of the private sector partner in the JV in accordance with EU Treaty principles; and
- where a public sector body wishes to select a partner for a JV and at the same time to award a contract for services, works or supplies to the JV, a single procurement exercise can be undertaken to select the partner and award the contract to the JV once established. This approach has been endorsed by the European Commission in its Interpretative Communication on IPPPs and avoids the need for two separate competitions (i.e. one to select the partner and a further competition to award contracts to the JV). An example of this “one competition approach” is the Building Schools for the Future programme (“BSF”), where the outcome of the competition is that the winning bidder secures his place as a shareholder in the newly established Local Education Partnership (“LEP”) and the LEP, once established, then has the right/obligation to deliver BSF schools projects either through the LEP itself or a special purpose company managed by the LEP.

9.5 In any event the applicability of the EU public procurement rules and most appropriate approach to competition should be the subject of independent legal advice.

Competition law

9.6 Competition law is likely to apply to a JV regardless of its classification, as it will be engaged in commercial or economic activities and thus is likely to come under the definition of “undertaking” in both UK and EC competition law.⁷⁵

9.7 Public sector bodies wishing to establish JV entities should not see competition law as a barrier, especially if their activities are aimed at increasing competition in a market. However, this is an area where many public sector bodies will be less familiar.

9.8 Annex K provides information on the two main aspects of competition law to be considered when setting up the JV, namely:

- merger control (under the 2002 Enterprise Act and the EC Merger Regulation); and
- anti-competitive agreements (the Section I prohibition of the 1998 Competition Act, and Article 81 of the EC Treaty).

⁷³ Reference: C(2007)6661, Brussels 05.02.2008.

⁷⁴ Where the JV is entirely controlled by a public sector entity, or more than one public-sector entity, there is within ECJ Case Law an exemption from the public procurement rules in respect of procurements by the controlling entity or entities. Clearly a JV with control shared with the private sector will not meet this criterion. Moreover, this exemption – known as the Teckal exemption after the case which gave rise to it “*Teckal Srl v Comune di Viano and Azienda Gas – Acqua Consorziale di Reggio Emilia (C-107/98)*” is quite narrowly construed and there must be adequate control and the supplying entity needs mainly to supply only the controlling authority or authorities.

⁷⁵ See *Public Sector Bodies and the Competition Act 1998*, Office of Fair Trading. (www.offt.gov.uk/shared_offt/business_leaflets/ca98_mini_guides/oft443.pdf).

9.9 A further aspect of competition law, abuse of a dominant position in a market, may also be relevant after the JV has been set up, particularly if the activities of the JV are in a niche or uncompetitive area.

9.10 The public sector body and private sector participant engaged in the JV should determine whether or not they are compliant with the Competition Act 1998 (or other competition laws) in conjunction with their legal advisers. The Office of Fair Trading (OFT) has provided guidance to explain how the various competition laws apply.⁷⁶ It can also provide informal advice to help in the determination of such issues.

9.11 Consideration also needs to be given at the outset to the application of procurement rules and competition law post formation of the JV. For example, the ability, or otherwise, of a public sector body to award works or services to the JV or any associated body should be planned and included within the original competition strategy and JV arrangements.

Obtaining VfM through competition

9.12 Government policy requires public sector bodies to obtain VfM in their use of public monies. VfM can be difficult to assess in selecting a partner for a JV (Chapter 4 sets out some of the issues in detail). Usually, the best way to obtain and demonstrate VfM is to run a competition to select a JV partner. In particular:

- competition is likely to be the best, and in some cases the only, way to test the market and establish a justifiable price for the public sector's contribution to the JV;
- a well-run competition will allow the public sector to demonstrate that it has sought and achieved best value;
- the chances of a challenge under the State Aid rules may be mitigated (see Chapter 3 and Annex C), although holding a competition is in itself no guarantee that the requirements of the State Aid rules have been met; and
- a competition will usually be the best way to demonstrate compliance with EU Procurement Rules. If there are particular instances, such as the ownership of intellectual property or specialist assets or skills, which may limit the number of potential partners (e.g. where there has been a development agreement leading to joint ownership of intellectual property)⁷⁷ then the public sector body should seek legal advice as to the application of the EU public procurement rules to its situation. The overarching aim is always to ensure best value, bearing in mind the benefits that an open and competitive environment can deliver and the requirements of the EU public procurement regime.

9.13 There are broadly two methods of selecting a partner competitively: open competition or (subject to EU Treaty principles) a targeted approach. The process for each are described below.

9.14 In cases where a private sector partner approaches a public sector body with an innovative idea, which it does not want advertised more broadly (e.g., if it has any intellectual property right to protect), public sector bodies should take appropriate steps to protect the intellectual property of the potential partner. If a competitive process follows an approach with an innovative idea, the process should be designed to test whether the market can deliver

⁷⁶ Available from the OFT website: www.offt.gov.uk/shared_offt/business_leaflets/ca98_mini_guides/oft443.pdf.

⁷⁷ Note that public sector bodies should therefore be careful about taking actions which may limit future competition.

alternative propositions meeting the public sector body's requirements rather than competing claims based on the original innovative idea.⁷⁸

Typical selection processes

9.15 As noted earlier in this Chapter there are broadly two methods of selecting a partner competitively: open competition or (subject to EU Treaty principles) a targeted approach. The choice of approach will depend on the particulars of the case and whether the EU public procurement rules or EU Treaty principles apply. The overall aim, whatever process is followed, is to select the partner best able to deliver the outcomes sought by the public sector body. In this context it is important to note that whilst many of the provisions of JV agreements and subsidiary contracts may be regarded as standard, in practice they will be intensely negotiated by prospective partners and so are likely to be settled on terms more attractive to the public sector if the negotiations take place under competitive conditions. The same is also true as regards the determination of price and other considerations. As such, the open competition approach, when it is viable, has advantages.

9.16 Both processes have much in common, and should involve:

- identifying and investigating the market (considering type, geography, size, players, strategy etc.);
- identifying and investigating the main players (considering philosophy, track record, geography, strategy, market share, marketing skills, competitors etc.);
- developing selection criteria to be used to short-list potential partners usually based on their financial standing, technical capabilities, competencies, experience, attributes and legal status;
- short listing and having a dialogue with short-listed bidders;
- developing evaluation criteria to be used to select a preferred partner based on their financial and non-financial proposals and desired strategic outcome; and
- appointing a preferred partner.

9.17 The public sector body will need to consider the timetable for each of these stages, how many potential partners should be short listed, and how many should enter the dialogue phase. The timetable and conduct of the selection process will also depend on whether the EU public procurement rules apply, and the time and resources that it is appropriate to spend on forming the JV.

9.18 Most JV formations are likely to be particularly complex, as it is often difficult for the public sector body to predict the optimum technical, financial or legal solution at the outset, and without some form of dialogue being conducted with bidders. Accordingly, where the EU public procurement rules apply, the use of the competitive dialogue procedure may be justified and the most appropriate procurement method to use. However, as the competitive dialogue procedure is not a procurement procedure of first resort and its use must be justified, it is important that the public sector body considers, on a case by case basis, whether it can be used, and also maintains a clear audit trail to document the reasons for its decision.⁷⁹

⁷⁸ If the public sector body considers it appropriate to pursue a JV without following a competitive process, and particularly if the contract is for works or services and is above the relevant EU threshold, it is likely to require advice on the procurement law implications of this. It is possible in certain circumstances to use the negotiated procedure without competition, i.e. use a "single tender action", but the circumstances are carefully circumscribed.

⁷⁹ See further the OGC/HMT Guidance on Competitive Dialogue 2008, (http://www.ogc.gov.uk/documents/ogc_hmt_2008_guidance_on_competitive_dialogue.pdf).

Criteria for selection

9.19 The public sector body needs to be clear about the qualities, characteristics and assets it is looking for in private sector partners for the JV. Part of the rationale for establishing the JV will be to access private sector assets which are needed, but which may not be available, in the public sector body, such as financial resources, technological expertise, marketing skills, access to customers and markets etc. However, for the JV to be successful it is also important for partners to have the right qualities on “softer” issues, such as cultural fit and relationship management, which are typically harder to evaluate. Public sector bodies also need to consider the reputation and potential conflicts of interest of partners (see Chapter 3).

9.20 These characteristics and assets should form the basis of the selection criteria used to target potential partners or create a shortlist. Care should also be taken, particularly where the EU public procurement rules apply, to ensure that the information requested from potential partners at this stage, and the selection criteria against which this information will be assessed, are permitted under the rules and do not stray into the territory of the criteria which will be used to select the preferred partner later in the process (i.e. contract award criteria). Criteria may be weighted and scored, in order to help increase the objectivity of the final decision, although where the EU public procurement rules do not apply, this may not always be necessary or appropriate.⁸⁰

9.21 Some criteria and possible areas of questioning are set out in Table 9.A below. In most circumstances, public sector bodies should consider using external advisers to help in partner appraisal.

Table 9.A: Possible partner selection criteria

| Characteristic/Asset | Possible questions/selection criteria |
|--------------------------|--|
| Relationship Management | <ul style="list-style-type: none">• Vision: why they want to get involved• Objectives: what they want to get out of the partnership• Stated policy on partnering• Transparency in dealings |
| Organisational strengths | <ul style="list-style-type: none">• Company background• Principal activities• Management capacity• Ownership structure: parent and subsidiaries• Core business• Stability of market place in which company operates• Diversity of operations• Performance and reliability within market place |
| Financial strengths | <ul style="list-style-type: none">• Statement of turnover in respect of proposed JV entity• Key ratios: net worth, credit rating, profitability, liquidity, gearing, debtor delays, stock turnover |
| Technical capability | <ul style="list-style-type: none">• Questions/criteria will depend on the specifics of the project |

Business plan

9.22 A comprehensive business plan must be developed and maintained with input from both parties at the outset of the formation of the JV. The JV business plan should form a key part of the evaluation and competition process.

9.23 The business plan will also need to be updated on a regular basis once the JV is established. This is a subject in its own right and is outside the scope of this Guidance.

⁸⁰ If the EU public procurement rules apply, the specific rules on selection criteria (i.e. used for pre-qualification or short-listing) and award criteria (i.e. used for contract award/selection of preferred partner), must be followed and the principle of transparency observed. These require the advance disclosure of criteria (and any sub-criteria) and their relative weightings and potentially any accompanying scoring methodology.

However there is an extensive body of guidance and best practice material available in text books or via the internet⁸¹.

9.24 The business plan may be arranged along the lines set out in Table 9.B below.

Table 9.B: Example business plan headings

| | |
|--|--|
| Summary of the proposal | <ul style="list-style-type: none"> • Short, succinct and complete |
| Background | <ul style="list-style-type: none"> • History • Understanding of business |
| Picture of the Business to be created | <ul style="list-style-type: none"> • What is the business? • How it will be constructed? • How will it be delivered? • Where will it be delivered? • What is the value chain? • What are the key processes? • What are the unique selling points? |
| The Market | <ul style="list-style-type: none"> • Description, size, growth • Customers • Competitors • Strategic strengths/competitive advantage • Delivery channels |
| Trading Plan | <ul style="list-style-type: none"> • future view of balance sheet, P&L and cash flow (typically covering next 3-10 years) • Seasonality • Trading forecasts • Assumptions • Sensitivities • Required investor rates of return |
| Management and Organisation | <ul style="list-style-type: none"> • Organisational structure • Key managers • Staff levels and skills |
| Budget | <ul style="list-style-type: none"> • Capital requirements • Projected revenues and costs • Underlying Assumptions |
| Financing | <ul style="list-style-type: none"> • How much, when and how raised? • Guarantees |
| Business Strategy | <ul style="list-style-type: none"> • Direction of the business • Governance • Why will it succeed? |
| Risk | <ul style="list-style-type: none"> • What are the risks? • How could they impact? • How will they be managed and resolved? • What is the break-even strategy? |

⁸¹ Many of the main clearing banks and the major professional services companies have guidance and pro forma business plans available on their respective websites.

10

Managing public sector interest in the joint venture

This final Chapter describes the distinction which must be drawn between the roles of the Board of Directors (or partnership equivalent) of a JV and its participants. To this extent the Chapter should be read alongside Chapters 5 to 8 in establishing the framework under which the JV will need to operate. Chapter 10 also addresses corporate governance, the manner in which the public sector should monitor the ongoing activities of JV and the structure and importance of business plans and budgets.

The Chapter describes:

- the governance structures and processes for managing the JV entity;
- director and partnership administrator roles; and
- approaches to dealing with conflicts of interest, confidentiality and dispute resolution.

Managing the JV entity

10.1 The public sector body and private sector participant must decide how the JV is to be managed. The JV should have sufficient freedom to carry out its activities on a day-to-day basis without direct involvement of any participant so that it can achieve its agreed objectives (see also Chapter 3).

10.2 The JV must, however, be accountable to the participants and certain issues will require the participants' approval. These are often known as "reserved matters" or "veto rights". These would typically include:

- approval of business plans, budgets, material contracts and any material deviation by the JV from those documents;
- changes in the distribution policy;
- introduction of new funding, whether in the form of equity or debt;
- introduction of a new participant;
- veto rights regarding the appointment of key personnel;
- changes to the underlying constitutional documents; and
- termination or sale of a material part of the business or assets of the JV.

10.3 The structure of the JV will influence how it is to be managed. For example, a 50:50 JV is often deliberately structured so that both parties have equal representation on the board and equal voting rights. This structure has inbuilt potential for deadlock where no decision can be made if each party takes an opposing view. Where the participants hold unequal shares, a majority shareholder will usually expect to have a final say on matters to be decided at the board and may have greater reserved decision making-rights, whilst a minority shareholder will have more limited rights as appropriate in order to protect its position (see Chapters 3 and 8). However, it is not axiomatic that the split of economic interest represented by ownership of shares or rights to receive profits matches the split of voting rights or control over certain decisions, as the parties may, for good business reasons, wish to agree an asymmetric arrangement.

10.4 Example 8 below provided an example of a more complex two-tier JV structure set up to manage multiple public sector body interests in a JV with a private sector participant.

Example 9: Harwell Science and Innovation Campus JV

The UKAEA and the STFC entered into a partnership with Goodman International, a property development and management company, on 13 August 2008. The partnership was intended to develop and manage property and infrastructure on the Harwell Science and Innovation Campus in Oxfordshire and thereby build value, indirectly assist in improving the impact of public investment in science, support science and innovation, and champion the Campus internationally.

The JV was structured as an English Limited Partnership with the public and private sector each holding 50% of the equity, initially through the injection, respectively, of land and cash of an equal value. The Partnership is managed by a General Partner company, the Board of which comprises four Directors, two nominated by the public sector body and two by the private partner. Control is thus also 50:50 – decisions have to be made on a unanimous basis. The Partnership has been set up for an initial term of 20 years and is classified in the private sector. Following the initial equity transfers, further land (and matching cash) will be drawn down from the partners progressively as the Campus develops although the Partnership assumed responsibility for managing Campus land from the outset.

The public sector body interest in the Partnership is held by a separate Limited Partnership between UKAEA and STFC. This helps maintain a unified and integrated public sector objective for the JV and, inter alia, enables the composition of public sector interests to be changed without affecting the structure of the main Partnership.

Source: UKAEA

Governance and level of JV autonomy

10.5 The public sector body will need to consider how best to monitor the ongoing activities of the JV. In all cases designated individuals within the public sector body should be responsible for the review of business plans, budgets and financial information regarding the ongoing activities of the JV. These individuals should not be directly involved with the day to day operations of the JV or act as directors of the JV. In addition mechanisms should be put in place so that matters requiring its approval as a participant can be dealt with expeditiously.

10.6 It is important to consider the governance arrangements that should be put in place to provide control and protection, particularly when the JV is at least partly funded or otherwise supported by the public purse. These should be established to minimise the risk of conflict of interest and give reassurance to key public sector stakeholders over the propriety of the JV arrangements. Examples of such arrangements include non-executive steering groups, advisory councils, audit committees, remuneration committees, etc. Reference to the Turnbull Report⁸² should be made for further guidance on corporate governance.

10.7 Responsibility for the supervision and management of the JV and its business lies with the JV's Board (or partnership equivalent), except for those matters which UK company law requires to be decided by participants or which the JV has reserved for its participants. Limited Liability Partnerships (LLPs) can be created to have similar management/executive structures to the corporate ones described in this Chapter. Limited Partnerships (LPs), with a single managing partner who manages the business, will be structured differently.

⁸² Combined Code on Corporate Governance. See www.icaew.com/index.cfm/route/149390/icaew_ga/en/Technical_amp_Business_Topics/Topics/Law_and_regulation/FRC_Combined_Code_on_Corporate_Governance.

10.8 A decision will need to be made as to whether the Board is to be actively involved in the managerial decisions of the JV or operating in a more strategic/supervisory role. The outcome of this decision will influence the composition and structure of the Board. If the Board is to have an active executive role, then it should need to include individuals with the appropriate skills. If however the board is to have a supervisory role, reviewing overall strategy and key decisions, it will consist mainly of representatives of the participants. An executive management committee may need to be established to whom the supervisory Board can delegate conduct for the day-to-day running of the JV.

10.9 Ideally, the chairman should be selected on the basis of executive managerial experience, knowledge of the business and associated market, leadership, and an appreciation of the participants' original motivations for starting the JV. This role is key, as he/she may have to resolve major disputes (i.e. the future direction of the JV), and guide the management team through difficult times.

Directors'/ partnership administrators' roles

10.10 The primary obligation and legal duty of care of directors of a JV constituted as a company is to the JV itself and not to the person of whom they are the representative or by whom they are nominated. They have an obligation to exercise independent judgement and act in good faith so as to promote the success of the JV.

10.11 As the JV is owned by its participants, promoting its success should be assessed by reference to the participants and their long term interests, but directors are also required to take into account, when considering the promotion of the success of the venture, the interests of a number of other stakeholders, such as the JV's employees, suppliers, customers, and wider interests such as the environment. Further, the directors are not permitted to favour the interests of one participant over another and must act fairly as between the members of the JV.

10.12 Where the JV is insolvent, a director must consider the interests of creditors in preference to the interests of the participants. In fact, responsibilities to creditors in relation to insolvency arise in the run-up to insolvency or potential insolvency, not just after the event. This is a complex area in its own right and should it arise in practice directors should seek specialist legal advice.

10.13 It should be noted that directors' duties of the type owed by directors of limited companies are not owed by the members of an LLP or LP and, specifically, Part 10 of the Companies Act 2006 (which contains the provisions codifying directors' duties) does not apply to LLP or LP members. However, members do owe general fiduciary duties to the LP and LLP, such as a duty to avoid conflicts and duty not to profit personally from being a member of the LLP or LP. It is normal for obligations to be imposed on the members, via the LLP/Partnership agreement, to act in the best interests of the LLP/Partnership and not to act in conflict with its interests. Whilst these duties will legally be owed directly by the members of an LLP or LP, the persons administering the LLP or LP on behalf of the public sector body will need to act in accordance with these duties.

Conflict of interest and confidentiality

10.14 A director appointed by a participant may find they feel a conflict between acting in the interests of the JV and in the interests of the participant in circumstances where such interests are not the same. This may be particularly strong where the director is also an employee of the participant who has nominated them. This is an issue which will need careful consideration for civil servants and council officers/members who are nominated as directors and specific advice should be sought where appropriate. Where however a JV has a social purpose allied to the public sector body's statutory purpose, the risk of conflict may be ameliorated. Guidance on the

duties and responsibilities of directors is available from Companies House, and this should be read by directors before they sign to accept their directorship. There are also a number of training courses to supplement and reinforce good practice.

10.15 Directors' duties of confidentiality as determined by general law and the company's articles may restrict a director who is also a civil servant from passing any information or certain types of information to the public sector body appointing him or her as a director.

10.16 As of 1 October 2008 the law on directors' conflicts of interests has been codified into the Companies Act 2006. The change widens the duty so that a director must avoid potential conflicts of interest as well as actual conflicts. All actual and potential conflicts of interest must be disclosed to the board of the JV, regardless of the circumstances. The new law, however, does provide the ability for conflicts of interest disclosed by a director of a limited company to be approved by the board of directors (excluding, of course, the directors who have the conflict), whereas the pre-October 2008 law required shareholder approval.

10.17 A JV that was incorporated before 1 October 2008 may have to change its articles to give the board the power to approve conflicts.⁸³ If the JV is incorporated after 1 October 2008, this power is automatically incorporated in its constitution.

10.18 The constitutional documents and JV Agreement can help alleviate the concerns for a director appointed by a participant by:

- reserving certain matters (particularly those where conflicts are likely to arise) to be decided by the participants only and not by the board (see Section 10.1.2);
- imposing a restriction on a director from voting on any issue in which he/she has a conflicting interest;⁸⁴ or
- by expressly allowing a director to vote on a matter in which they have a conflicting interest, provided that the nature and extent of the director's interest has been fully declared to the board.

10.19 Civil servants acting as directors/partnership administrators have no less obligations and duties and therefore are vulnerable to enforcement action by other government departments/regulatory bodies, or sometimes even their own sponsor department.

10.20 For some of the reasons set out above the issue of when it is appropriate or not for civil servants to act as directors/partnership administrators can be a difficult policy issue and it is important therefore to be aware of potential liabilities, both individually and for the body, and to seek proper legal advice and take out appropriate insurance (see Chapter 8).

Dispute resolution

10.21 Carefully crafted mechanisms for dealing with disputes should be included in the JV arrangements such as those set out below:

- the appropriate levels of authority to be granted to representatives within the JV (in terms of value and materiality);
- where disputes should be escalated to more senior representatives of the participating bodies; and

⁸³ This only affects their interests qua the company and does not affect conflict from the parent authority perspective.

⁸⁴ This is the position at common law and is also set out in the standard Table A of the articles of association.

- the process to be adopted for resolving disputes at all levels (e.g. resolution by senior management, escalation to mediation/arbitration, etc.).

10.22 Public bodies have sometimes proved reluctant to invoke dispute procedures for fear of escalating the difficulty and souring the JV relationship. If however problems are left unresolved instead of being dealt with, they are likely to cause greater trouble in the longer run. Difficult issues should therefore be faced, not avoided, and where they cannot be resolved at management board level, then they should go through the agreed escalation procedure.

10.23 Characteristically this may involve the issue being taken, perhaps through an intervening stage, to the chief executive of the private sector participant and their equivalent in the public sector body. If this fails to resolve it, some sort of independent mediation process may be useful (and should be considered when the dispute resolution procedure is drafted in the contract). Only if this fails should some form of arbitration or legal proceedings be used. Where real deadlock is reached over core JV matters and it becomes impractical for the JV to continue its business, then the deadlock and, possibly, exit provisions may need to be invoked (see Chapter 8 for provisions that may reflect some of the routes to resolution mentioned above such as escalation or external advice).

A

Sample of public sector Joint Ventures

| Name | Purpose | JV Structure | Date Signed | Ownership | Case Study | Notes |
|-------------------------------------|--|--------------|-------------|---|------------|--|
| Central Government Body JVs | | | | | | |
| Actis | Private equity directed at International Development | LLP | 2004 | DIFD (40%) Private Shareholders (60%) | - | £6.8bn of funds in Africa, China, Latin America, South Asia and South East Asia. |
| Building for Business | Property asset management/development | LP | 2001 | One Northeast (50%) UK Land Estates (50%) | p.43 | |
| Dr Foster Intelligence | Improve quality and efficiency of health and social care through better use of information | Ltd Co. | 2006 | Dr Foster Ltd. (50%) NHS IC (50%) | - | NAO report critical of procurement process. |
| E Midlands Property Investment Fund | Regeneration in the East Midlands | LP | 2004 | EMDA (25%) HCA (25%) PSP (50%) | - | |
| English Cities Fund | Invest in mixed-use projects in assisted areas | LP | 2001 | HCA (50%) Amec (25%) Legal and General (25%) | - | £100m raised through the investment of £50m in equity from the three partners together with £50m in bank debt. |
| Fibreway | Fibre optics alongside canal network | Ltd Co. | 1990s | British Waterways (10%) Marconi (90%) | - | Subsequently rebranded as Ipsaris and then sold to Easynet. |
| Forest Holidays | Building and management of holiday centres | LLP | 2006 | Forestry Commission (50%) PSP (50%) | p.14 | |
| ISIS | Waterside regeneration | LLP | 2002 | British Waterways (50%) PSP (50%) | p.43 | |
| Microbial Solutions Ltd. | Technology to treat Metal working fluids | Ltd Co. | 2007 | Centre for Ecology and Hydrology H2O Venture Partners Oxford Capital Partners | - | Spin-out. |
| NATS Holdings Ltd | Air traffic control systems | Ltd Co. | 2001 | DfT (48.9%) Airline Group (41.9%) BAA plc (4.2%) Sharetrust Ltd. (5%) | - | Separating service provision from regulation (safety). |
| Network Space Ltd | Development of workspace in English Coalfields | Ltd Co. | 1999 | HCA (49%) Langtree Group (51%) | - | |
| NHS Shared Business Services | Shared service delivery | Ltd Co. | 2005 | DOH (50%) Steria Group (50%) | p.16 | |
| NorwePP | Property asset management/development | LP | 2006 | NW RDA (50%) PSP (50%) | p.14 | |
| ONEDIN | Development partnership | LP | 2008 | One Northeast (50%) Langtree (50%) | - | |
| Partnerships UK | Support and invest in Public Private Partnerships. | PLC | 2000 | HMT (45%) Scot. Min (4%) Private investors (51%) | - | |
| Priority sites | Land development in areas of market failure | Ltd Co. | 1997 | HCA (49%) RBS (51%) | - | |

| Name | Purpose | JV Structure | Date Signed | Ownership | Case Study | Notes |
|--|---|---------------------|-------------|---|------------|---|
| PxP West Midlands | Property regeneration partnership | LP | 2007 | Advantage West Midlands (50%) PSP (50%) | - | Also manages AWM's portfolio of investment properties. |
| QinetiQ | Defence Solutions | Ltd Co. | 2003 | MoD (19%) Public ownership (81%) | - | MoD has special shareholder rights such as the veto of certain contracts. |
| UKAEA and STFC property JV | Development of the Harwell Science and Innovation Campus in Oxfordshire | LP | 2008 | UKAEA/STFC (50%) Goodman (50%) | p.68 | The joint public sector interest in the partnership is held by a separate Limited Partnership between UKAEA and STFC. |
| Working Links | Employment programme for disadvantaged communities | Ltd Co. | 2000 | Shareholder Executive (33.3%) Mission Australia (33.3%) Manpower plc (16.6%) CapGemini plc (16.6%) | - | Voluntary Sector partner brought in following review. |
| Zoobiotics | Development of the medical use of larvae | Ltd Co. | 2004 | PUK Finance Wales Lansdales Bro Morganwg NHS Trust | - | Spin-out to successful JV. |
| Local Government JVs | | | | | | |
| BSF LEPS | Programme to build secondary schools | Ltd Co. | 2001 | BSF (10%) LA (10%) PSP (80%) | p.15 | |
| Croydon Council Urban Regeneration Vehicle | Replacement of council offices and town centre regeneration | LLP | 2008 | Croydon Council (50%) John Laing (50%) | - | Individual development projects held in a subsidiary vehicle and financed individually. |
| Customer Service Direct (CSD) | Shared services delivery | Ltd Co. | 2004 | BT Suffolk County Council | p.13 | JV between Local authority and private sector. |
| Kier Harlow Ltd. | Shared services delivery | Ltd Co. | 2007 | Harlow CC (19.9%) Kier (80.1%) | - | Also Kier Islington + Kier Sheffield (LLP) + Kier Stoke. |
| Newcastle Airport Holding Co Ltd | Airport owner/operator | Limited Company | 2001 | 7 LAs (51%) PSP (49%) | - | 7 local authorities own retaining the controlling share. Listed as public corporation. |
| NHS LIFT | Programme to build local GP centres | Ltd Co. | 2003 | PCT (20%) PFH (20%) PSP (60%) | p.15 | |
| Sea Space (Hastings & Bexhill Renaissance Ltd) | Public partnership to deliver 10yr business plan for regeneration | Co Ltd by Guarantee | | SEEDA English Ptnshps. East Sussex CC (<19.9%) Hastings BC (<19.9%) Rother DC (<19.9%) | - | Sea Space contracts through 50:50 SPVs with private sector for individual projects. |
| Service Birmingham | Shared services delivery | Ltd Co. | 2006 | Birmingham CC (35%) Capital Business Services (65%) | - | |
| Southwest One Ltd | Shared services delivery | Ltd Co. | 2008 | Somerset CC Taunton BC Avon and Somerset Constabulary IBM | - | |

Notes:

This list only represents a sample of JVs with the private sector (public to public JVs are not included).

A more comprehensive list of public sector classified entities can be found on the ONS website

www.statistics.gov.uk/downloads/theme_economy/MA23.xls.

A complete list of community interest companies can be found on the CIC regulator website at

www.cicregulator.gov.uk/coSearch/companyList.shtml.

B

Comparative table of main joint venture structures

Adapted from CLG *Structures for Service Delivery Partnerships Technical Notes, 2006*

| | Limited Company | Limited Liability Partnership ("LLP") | Limited Partnership ("LP") |
|------------------------------|---|--|--|
| Running the business: | A corporate body | A corporate body. Must be formed with a view to a profit but this can alter following set-up of the LLP. | A group of individuals with a common goal and a view to a profit. |
| Administration: | All limited companies must reflect their limited status in their registered names (although they need not trade in that name), invoices, business letters and websites. | All LLPs must have a business name that ends with 'Limited liability Partnership' or 'LLP' to indicate the entity's status. The name must be registered and the status must be shown on all business documents (including all letters) and on its website. | In a 'traditional' limited partnership there must be at least one 'general' partner who manages the day to day business and enters into contracts on behalf of all partners. The General partner is liable for all debts/obligations of the limited partnership A LP will also have limited partners whose liabilities are restricted to their investment in the LP. Limited partners may not take part in the LP's management and do not have power to legally bind the partnership. |
| | A company can have a single shareholder. It may also have only one director. The role of Company Secretary is now optional. The company must have an objects clause and must have a registered office. Under the Companies Act 2006, from 1 October 2009 a newly incorporated company will not have a Memorandum of Association; its objects (scope of business) will be unlimited by virtue of the 2006 Act. The Memorandum of an existing company will be treated as part of its Articles of Association and an existing company will be able to render its objects unlimited by changing its Articles. The | At least two persons/bodies are required to form a LLP. A LLP has unlimited capacity regarding objects. There must be a lawful business, a view to profit and a registered office. Although not compulsory, there should be a written partnership agreement. The Limited Liability Partnerships Act 2000 sets out default terms that apply in the absence of exemptions. | At least two persons/bodies are required to form a LP. A LP has unlimited capacity regarding objects. There must be a lawful business, a view to profit and a registered office. Although not compulsory, there should be a written Partnership agreement. The Limited Partnerships Act 1907 and the Partnership Act 1890 set out default terms that apply in the absence of exemptions. |

| Adapted from CLG <i>Structures for Service Delivery Partnerships Technical Notes, 2006</i> | | | |
|--|---|--|--|
| | Limited Company | Limited Liability Partnership ("LLP") | Limited Partnership ("LP") |
| | <p>Articles will continue to play an important role in the way in which companies are run.</p> <p>The maximum number of shareholders will be determined by the number of available shares/securities.</p> | <p>There is no maximum number of members within a LLP.</p> | <p>Subject to exceptions, a maximum of 20 partners in a LP.</p> |
| Key roles: | <p>Directors (of which there may be only one) need not be shareholders. Directors have specific fiduciary duties and responsibilities with regard to the company.</p> <p>Company Secretary required. The Board of Directors can bind the company.</p> | <p>No directors but concept of 'designated members' to undertake duties commensurate to that of a director of a company. There must be at least two designated members. If silent, all members are deemed designated members.</p> <p>Any member can bind the LLP, unless he had no authority and the third party knows this.</p> | <p>The general partner will undertake day to day management.</p> <p>A limited partner is not able to bind the partnership. However, any limited partner becoming involved in the management of the partnership will lose limited liability status as if he were a general partner.</p> |
| Decision-making: | <p>Process heavily regulated. Generally, 50% or 75% majority shareholders can take major decisions.</p> | <p>There is flexibility to determine in the agreement the rights to be afforded to different members and the extent to which partnership law is to be applied. If no agreement is in place, default provisions may be applied that require unanimous agreement from members.</p> | <p>There is flexibility to determine in the agreement the rights to be afforded to different partners and the extent to which partnership law is to be applied. If no agreement is in place, default provisions may be applied that require unanimous agreement from partners.</p> |
| Employee issues: | <p>Greater flexibility in staff reward options, such as share schemes and approved company pension schemes.</p> | <p>No shares and therefore no option for share reward schemes.</p> | <p>No shares and therefore no option for share reward schemes.</p> |
| Liability: | <p>The company itself is liable to the full extent of its assets. This offers members long-term protection from Creditors (including banks). Shareholders' liability normally restricted to the amount, if any, paid on their shares.</p> | <p>The LLP itself is liable to the full extent of its assets, whilst the liability of the members is restricted to their respective capital contribution plus the amounts of any personal guarantee.</p> | <p>The general partner is jointly and severally liable to for all of the partnership debts, in proportion of their partnership share. The liability of limited partners is restricted to their capital.</p> |

| Adapted from CLG <i>Structures for Service Delivery Partnerships Technical Notes, 2006</i> | | | |
|--|--|--|--|
| | Limited Company | Limited Liability Partnership ("LLP") | Limited Partnership ("LP") |
| BUT... | Protection may be limited if personal negligence is concerned, if personal guarantees are given, or, for directors who allow the company to trade in an insolvency scenario (fraudulent or wrongful trading). Many lenders may require personal guarantees from company directors in respect of the company's obligation. | Protection may be limited if personal negligence is concerned, if personal guarantees are given, or if the members permit the LLP to trade in an insolvency scenario (fraudulent or wrongful trading). Provisions for funds to be clawed back apply under the Insolvency Act, where a member takes out drawings leading to the LLP becoming insolvent. | If limited partners participate in management of the business, they are liable for all debts arising in that period as if they were a general partner. |
| Membership: | Shareholders own shares or securities in the company. Different classes of share give shareholders varying rights. | Members are entitled to profits and/or capital in accordance with a formal agreement. | Partners are entitled to profits and/or capital in accordance with the partnership agreement. |
| Reporting requirements: | Companies must satisfy: <ul style="list-style-type: none"> • Companies Act Requirements including Articles and Memorandum of Association. Forms 10 and 12 – statutory declaration. • Directors' Report and business review detailing how directors have complied with their obligations to promote the company's success. • Presentation to Annual General Meeting. • Potential audit requirements, subject to exemptions. • Public disclosure issue. • Full impact of employment legislation on all people working in the business. • CTSA tax return to the Inland Revenue. | LLPs have similar reporting obligations to companies: <ul style="list-style-type: none"> • Incorporation document in form approved by Registrar of Companies. A statement of compliance. • No Directors' Report. • No Annual General Meeting requirement but details provided to members. • Subject to same audit exemptions as a company. • Information distributed only to members of the LLP. • Partnership Tax Return to Inland Revenue. | There are no formal reporting requirements. Accounts are only available to full existing partners. Full accounts and disclosure required to Inland Revenue on Partnership Tax Return. |
| Status: | Greater commercial status and substance. | Good commercial status and substance. Recognised vehicle to receive funding. | Potentially less commercial status and substance. |
| Retention: | Profit retention at a low corporate rate can be beneficial where owners only wish to withdraw part of the profits. | Each member pays income tax (or corporation tax for a corporate member) at their marginal rate even if profits are not withdrawn from the business. | Each partner pays income tax (or corporation tax for a corporate partner) at their marginal rate even if profits are not withdrawn from the business. |

| Adapted from CLG <i>Structures for Service Delivery Partnerships Technical Notes, 2006</i> | | | |
|--|--|--|---|
| | Limited Company | Limited Liability Partnership ("LLP") | Limited Partnership ("LP") |
| | Flexibility on retention and payout of profits, including option to reward individual shareholder directors via dividend and/or salary. | Flexibility on retention and payout of profits, including ability to vary profit entitlement. | Flexibility on retention and payout of profits, including ability to vary profit entitlement. |
| BUT... | <p>In practice, companies are used where there is an intention to retain profits in the long term in order to obtain lower tax rates.</p> <p>Additional tax cost of extracting profits from the company:</p> <ul style="list-style-type: none"> • There may be an additional tax charge in a corporate structure on asset disposals; where the company makes a gain (and pays corporation tax) and the value of the shares increase, a charge may also arise on the increase in share value on a disposal by the shareholders. • Company profits will be subject to corporation tax and, when distributed, will be subject to income tax in the hands of an individual shareholder. • Generally receipt of a dividend by a UK resident corporate or public sector shareholder will not be a taxable receipt • Tax exempt public sector shareholders will get no credit or refund for tax paid by the company on gains. | <p>In practice, many LLPs likely to pay out profits as they arise, subject to working capital requirements.</p> <p>Profits are attributed directly to the partners as they arise and there is no further tax payable by the partners as and when the profits are distributed.</p> <p>There are therefore no double tax charges for corporate members of an LLP; income and gains are taxed in the member company only as the LLP is transparent.</p> | <p>In practice, many partnerships likely to pay out profits as they arise, subject to working capital requirements.</p> <p>Profits are attributed directly to the partners as they arise and there is no further tax payable by the partners as and when the profits are distributed.</p> <p>There are therefore no double tax charges for corporate partners in an LP; income and gains are taxed in the partner corporate entity only as the LP is transparent.</p> |
| Losses: relief by shareholders/members/partners | Shareholders may, depending on their tax profile, wish to ensure that they have access to losses incurred by the company. Care will have to be taken to ensure that the group relief or consortium relief rules can be utilised. | An individual member may be able to use trading losses against other personal income and/or capital gains. In addition, they have specific relief available for losses in early years of a business. | An individual partner may be able to use trading losses against other personal income and/or capital gains. In addition, they have specific relief available for losses in early years of a business. |
| | If the group relief or consortium relief rules cannot be utilised a shareholder cannot get income tax relief for any | Usual corporate loss reliefs including group or consortium relief may apply to a corporate member's share of loss. In | Usual corporate loss reliefs including group or consortium relief may apply to a corporate partner's share of loss. In all cases, |

| Adapted from CLG <i>Structures for Service Delivery Partnerships Technical Notes, 2006</i> | | | |
|--|--|--|--|
| | Limited Company | Limited Liability Partnership ("LLP") | Limited Partnership ("LP") |
| | corporate losses except in limited circumstances on a disposal of the shares. There is no special relief for losses in early years of trading. | all cases, loss relief is limited to the amount of member's contribution less amounts withdrawn (plus, potentially, retained profits). If losses cannot be fully utilised, they can be carried forward and potentially used later. | loss relief is limited to the amount of partner's contribution less amounts withdrawn (plus, potentially, retained profits). If losses cannot be fully utilised, they can be carried forward and potentially used later. |
| Interest on borrowings by shareholder/ Partner: | Potential income tax relief for acquiring shares and making loans subject to conditions. | More straightforward relief for capital contributions. | More straightforward relief for capital contributions. |
| VAT: | <p>Company is separate entity for VAT purposes and liable for VAT registration, subject to normal rules.</p> <p>Company may be able to join a VAT group, subject to normal conditions.</p> | <p>LLP is separate entity for VAT purposes and liable for VAT registration, subject to normal rules.</p> <p>LLP may be able to join a VAT group with other companies, subject to normal conditions relating to control.</p> | Partnership is separate entity for VAT purposes and liable for VAT registration, subject to normal rules. |
| Anti-avoidance: | | Specific rules apply to investment and property LLPs; especially where member is a tax exempt body. | |
| Profit extraction: | Generally permitted for "distributable profits" only (i.e. taking into account realised profits and losses). | Potentially more flexible: equity participation offered but without the restrictions of shares: flexible reward strategies. | Potentially more flexible: equity participation offered but without the restrictions of shares: flexible reward strategies |
| Dividends: | Family members can also extract funds as shareholders via dividend payments subject to anti avoidance provisions. | n/a | n/a |
| Pensions: | <p>Directors/employees pay pension contributions by reference to amounts extracted as salary and not dividends.</p> <p>A company can set up a company pension scheme.</p> | <p>Partners pay pension Contributions by reference to earnings.</p> <p>A LLP cannot set up a corporate pension scheme for members.</p> | Partners pay pension contributions by reference to earnings. |



State Aid

C.1 State Aid issues can arise when the public sector confers a direct or indirect financial advantage on the JV. The key test is whether the recipient of the advantage is receiving a benefit which they would not have received in the normal course of business or on terms which would not be available in the market. The relevant article of the EC Treaty (article 87) can be broken down into four tests to establish whether State Aid rules apply. State Aid will only be present if all four tests are met:

- *Is the financial advantage granted by the State or through State resources?* This refers to the many direct and indirect ways in which State Aid may be granted. There must be a financial cost to the state for State Aid to be present, such as, for instance, the provision of loans on preferable terms (which are different to the private sector participant's loans) or sale of land at an undervalue.
- *Does the measure favour certain undertakings or the production of certain goods?* Only measures favouring certain recipients are the concern of the State Aid rules; general government measures such as economy-wide tax rates are not covered and benefits for individual citizens are not State Aid.
- *Does the aid affect trade between Member States?* This includes potential effects. Although in many cases JV companies may be planning activities in the UK only, if either/any of their parent companies are economically active or potentially active in other EU countries, the State Aid rules will normally apply. Alternatively if the activities of the JV are simply of a type which could be undertaken by entities in other states (e.g. the activities relate to products or services which are traded between Member States) any aid to the JV may be deemed to affect trade. This is even where the JV does not itself trade with other Member States. Very small amounts of aid have also been shown to affect trade.
- *Does the measure distort or have the potential to distort competition?* This is the crucial factor when determining the applicability of the State Aid rules. The test will be met where the aid potentially or actually strengthens the position of the recipient in relation to its competitors. Almost all selective aid will have the potential to distort competition - regardless of the scale of potential distortion or market share of the aid recipient. The test is therefore relatively easily met.

C.2 In the context of Public Private Partnerships, the last test, concerning the distortion of competition, could be important. Possible distortion of competition could occur at a number of different levels in a JV. A benefit may accrue to the private sector participant(s) in a JV entity deal, or as a cross-subsidy to the JV itself, or to the ultimate consumers. The JV proposition could, however, be framed in such a way as to minimise the potential for distortion of competition, in ways such as the following:

- *Possible aid to private sector partner?* This can often be addressed by a competitive and fully transparent selection process, with the private sector participant paying the appropriate premium for entering into the JV. However if bids are merely for the lowest subsidy needed to run a service aid could still arise. There will also be no State Aid if the "market economy investor principle" (MEIP) applies. Where there is

both public and private investment in an enterprise, the MEIP test can be demonstrated where:

- 1 there is concomitance – i.e. the private investor invests on exactly the same terms and at the same time as the public investor; or
 - 2 the respective public/private investments are on a *pari passu* basis – i.e. although the investments are not on identical terms they are made on the basis of equal risks and rewards.
- *Possible aid to the JV?* This can usually be addressed by fair and commercial pricing of all the asset(s) contributed by the public sector partner to the JV, also translating into a fair share allocation and fair dividend policies. Care must be taken with hidden assets, such as intellectual property rights, which may remain in the public sector but be used by the JV after its creation. Use of such assets must be on arms length terms and charged in full to the JV at commercial rates or made available to the JV's competitors on equal terms.
 - *Possible aid to ultimate consumers?* This can be addressed by fair and commercial pricing of the good/service supplied by the JV.

C.3 Finally it should be considered if:

- Any *de minimis* exemption or block exemption⁸⁵ (including the block exemption relating to aid for small or medium sized companies) applies; or
- The services provided are “services of general economic interest” or, “public services obligations” and the compensation or aid can be seen as provided only for the operation of public services facilities or services in the general economic interest. This can be a difficult test to satisfy.⁸⁶

C.4 BIS produces thorough guidance on the State Aid rules, revised most recently in 2007.⁸⁷

⁸⁵ Commission Regulation (EC) no 800/2008 of 6 august 2008.

⁸⁶ See *Altmark Trans GmGH* case 280/00 2003 ECRI-7747 and related European Commission decision on exemption from notification for aid for certain SGEIs (2005/842/EC of 28 November 2005) and the related Commission Framework on SGEIs not falling within the decision (OJC 297 of 29 November 2005).

⁸⁷ BIS State Aid Branch, email: bis.enquiries@berr.gsi.gov.uk or telephone 020 7215 5000.

D

Classification

D.1 Decisions on the classification of the JV to the public or private sector will be based on control of general governance policy.⁸⁸ Some of the common controls that ONS take into account when determining classification include:

- *appointment rights*. If the public sector has the power to appoint a majority of the board/trustees then the JV will be classified to the public sector. Where the public sector appoints a minority ONS will also consider if the minority has a majority of control; e.g. control within the JV is devolved to specific committees and the public sector appointees have a controlling interest on those committees.
- *ownership*. Even where the public sector body owns 50% of the JV's shares or fewer, the use of different classes of share with different rights may still give the public sector body effective control.
- *multiple sponsorship*. Where a body is owned or controlled by a number of public sector bodies it is the overall weight of the public sector that counts. Hence, if five public sector bodies each have a right each to appoint one director, and the board comprises nine or fewer directors, the body will be classified in the public sector.
- *special shares*. The existence of very narrowly defined Government powers, directed primarily at preventing undesirable changes of ownership, or the disposal of material assets, need not amount to control. Please note however that any "golden share" rights reserved by public bodies to maintain control and prevent a JV from take-over may now be deemed a breach of a member state's obligations under Article 56 EC (free movement of capital).
- *special terms in the JV's constitution*. The JV's Memorandum and Articles or Partnership Deed or JV Agreement may have terms that require the public sector founder's consent for certain actions, or before the memorandum and articles may be changed. Where such restrictions are time limited and are intended to give an initial period of stability to a new body, they need not amount to control. Permanent restrictions over important parts of the JV's work would normally amount to control. The distinction depends on whether such controls are active or passive. Setting out the purpose and operational guidelines for the JV when it is set up would be passive control; defining circumstances in which the public sector body could intervene and make decisions affecting how the organisation is run is active control. Active control would amount to actual control; passive control need not do so.
- *special regulation*. Regulation over external actions - such as price regulation, and regulation of markets - is unlikely to amount to control. Where regulation extends to internal management – e.g. pay levels or borrowing - then it could be seen as taking control.

⁸⁸ Treasury guidance paper on Sector Classification is available from: www.hm-treasury.gov.uk/d/classification_pack.pdf under the heading of public spending and reporting (budgeting and classification).

D.2 In determining who controls a body, ONS considers the overall reasonableness of the decision. So a classification decision is often not as simple as looking for a single clause that controls the body instead the ONS look at the body as a whole and the total influence government holds over the actions of that body. Therefore a weight of minor controls may lead to a public sector classification.

D.3 The constitutional documents of the JV will set out the control rights of each partner. The rights given to a public sector partner in a JV can appear to be significant in terms of control. However, such rights should not necessarily mean that the JV has to be classified to the public sector, provided that the rights are similar to those enjoyed by the private sector participant and exist solely to protect the public sector founder's financial stake in JV.

D.4 Nonetheless, Government rights giving control over the JV in order to further Government policies (such as locating an operation in a particular part of the country) or to avoid political problems (such as big pay increases for directors) could be enough to tip the balance in favour of classification to the public sector.

E

Accounting treatment

E.1 For accounting purposes, the public sector partner's relationship with the entity can be determined to be that of a subsidiary, associate or 'JV'. The term 'JV' has a narrow sense in this context, and should not be confused with the wider meaning that is used elsewhere in this Guidance.

UKGAAP and IFRS

E.2 Central government and NHS bodies will report under International Financial Reporting Standards (IFRS) from the 1 April 2009, as amended for application in the public sector context.⁸⁹ Until then, accounting under UK GAAP continues to be relevant. In broad terms the same principles apply under both sets of guidance, such that it is the level of control that determines the accounting treatment.

E.3 Under UK GAAP, Financial Reporting Standard (FRS) 2 – *Accounting for Subsidiary Undertakings* (supplemented by FRS 5 – *Reporting the Substance of Transactions*) and FRS 9 – *Associates and Joint Ventures* provide appropriate guidance. Under IFRS the key standards are IAS 27 – *Consolidated and Separate Financial Statements* and IAS 28 – *Investments in Associates*, and IAS 31 – *Interests in Joint Ventures*. IAS 27 is equivalent to FRS 2, while IAS 28 and 31 are equivalent in combination to FRS 9.

E.4 Details of accounting determination and treatment can be found in the relevant accounting standards as set out above. Table E.1 below briefly describes details of the accounting determination of the entity type under UK GAAP and IFRS.⁹⁰

E.5 Having identified the accounting determination of the entity, the public sector partner needs to ensure that their financial statements are prepared correctly. If the sponsoring public sector body is outside the departmental consolidation boundary as defined in the Financial Reporting Manual (FRM) or International Financial Reporting Manual (iFRM) (e.g. trading funds, NDPBs, public corporations, NHS providers), then the accounting treatment of public sector partner will follow the relevant accounting standards, under either UK GAAP or IFRS.

E.6 Accordingly under UK GAAP, subsidiary undertakings should be reflected in the accounts of the body to give a true and fair view of the financial position and profit and loss account for the group as a single economic entity, i.e. the subsidiary should be consolidated with the parent.

E.7 FRS 9 establishes that associate undertakings should be incorporated into the sponsoring body's consolidated accounts using the 'equity' method,⁹¹ and JVs using the 'gross equity' method.⁹² In the sponsoring body's individual company accounts its interest in the entity will be accounted for as a fixed asset investment. Where the sponsor body has no subsidiaries and

⁸⁹ Local government bodies will move to IFRS in April 2010.

⁹⁰ Further guidance is available by contacting HM Treasury (Financial Reporting Policy Team).

⁹¹ Under the equity method the sponsor body should show its share of the entity's operating result immediately after the group operating result in the profit and loss account, and disclose its share of the net assets of the entity as a single figure in its consolidated balance sheet.

⁹² Under the gross equity method the sponsor body should show its share of the entity's turnover, operating result and line items below operating result as well showing its share of net assets on its consolidated balance sheet must disclose its share of the gross assets and gross liabilities as an additional disclosure of that amount.

therefore does not prepare consolidated accounts, FRS 9 requires the disclosure of information on associate undertakings and JVs equivalent to that required in consolidated accounts.

Table E.1: Accounting determination for a JV

| Entity | Nature of relationship | Description of the defining relationship under uk gaap | Description of the defining relationship under ifrs |
|-------------------|---|--|---|
| Subsidiary | <p>Investor has the power to exercise, or actually exercises, dominant influence or control over its investee.</p> <p><i>Note the requirement for there to be a 'participating interest' (i.e. an interest in the form of shares or similar) to trigger this part of the definition has been removed under UK GAAP.</i></p> | <p>Control is the ability of an entity to direct the operating and financial policies of another entity with a view to gaining economic benefits from its activities.</p> <p>To have control, the investor must have both:</p> <p>(a) the ability to deploy the economic resources of the investee or to direct it; AND (b) the ability to ensure that any resulting benefits accrue to itself – with corresponding exposure to losses – and to restrict the access of others to those benefits.</p> | <p>Under IFRS a subsidiary is defined as an entity, including an unincorporated entity such as a partnership that is controlled by another entity.</p> <p>The most significant difference of principle compared to UK GAAP is that IAS37 focuses on the power to control, whereas the UKGAAP definition also encompasses situations in which control is actually exercised in practice notwithstanding the fact that the power to control is not overtly present.</p> |
| Associate | <p>Investor holds a Participating Interest and exercises Significant Influence.</p> | <p>The investor has a long-term interest and is actively involved, and influential, in the direction of its investee through its participation in policy decisions covering the aspects of policy relevant to the investor, including decisions on strategic issues such as:</p> <p>The expansion or contraction of the business, participation in other entities or changes in products, markets and activities of the investee; and determining the balance between dividend pay outs and re-investment.</p> | <p>An associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence, and which is neither a subsidiary nor an interest in a JV. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies.</p> |
| JV | <p>Investor holds a long-term interest and shares control under a contractual agreement.</p> | <p>Acting together, the venturers control the venture and there are procedures for such joint action. Each venturer has (implicitly or explicitly) a veto over strategic policy decisions.</p> | <p>A JV is defined as a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control.</p> |

E.8 While the JV principles in IAS 31 and FRS 9 are very similar, the respective presentation requirements are different. FRS 9 only allows gross equity accounting, while IAS 31 allows equity accounting or a proportional consolidation method, while strongly recommending the latter due to its representing the economic substance of the arrangement more closely.

E.9 It should be noted that, while the alternative presentation methods allowed under IAS 31 compared to those required under FRS 9 give potentially very different outcomes on a line-by-line basis, these presentations' impact on overall retained surplus and net worth will not change from that of FRS 9.

E.10 Section 2.4 of the FReM provides guidance for those public sector sponsors inside the departmental consolidation boundary (e.g. government departments, on Vote agencies, NHS purchasers). In practice, this will mean that an interest in a subsidiary undertaking, associate undertaking or JV is treated as a fixed asset investment (on the assumption that the JV is itself outside the resource accounting boundary). The same guidance is applicable under the iFReM.

E.11 However, in these circumstances, the public sector body should still disclose equivalent information to that required by FRS9 for associate undertakings and JVs (as noted previously). The draft iFReM does not change these requirements. That is the JV should be treated as a non-current asset investment but with disclosures made in line with the requirements of IAS 31.

E.12 The table overleaf summarises the difference in presentation between FRS 9 and IAS 31.

Table E.2: FRS9 vs IAS 31 accounting presentation

| | FRS 9 – Gross Equity Method | IAS 31 – Equity Method | IAS 31 – Proportionate Consolidation |
|--------------------------------|---|--|--|
| Income and expenditure account | Share of the JV's operating profit and each line item after operating profit, are presented separately in the income statement. Additionally, the investor's share of its JVs' turnover should be shown on the face of the primary statement, but separate from the group turnover. | The investor's share of profits or losses after tax is shown as a single item in the income statement. | Either Line-by-line combination of share in all items on consolidated financial statements; Or Separate line-by-line presentation of share in all items on consolidated financial statements. |
| Balance Sheet | Share of net assets with share of gross assets and liabilities shown as an amplification of this amount as additional disclosure. | Share of net assets | |

E.13 Public sector subsidiaries, associates and 'JVs' will be consolidated into Central Government Accounts and/or Whole of Government Accounts in due course.

E.14 Separately, the JV will need to consider its own financial reporting arrangements to ensure that it complies with any relevant legislation as well as open and transparent best practice.

Limited Partnerships (LP) and Limited Liability Partnerships (LLP)

E.15 An LP or LLP agreement is a specific type of legal structure used to constitute an entity. LP and LLPs have specific membership structures and, in the case of a LP, will include the use of a 'general partner' to direct the organisation. Note that different jurisdictions use different structures, e.g. a Scottish LLP is different to an English or Welsh LLP. When accounting for an LLP care should be taken to ensure that the financial statements reflect the relationship between the public sector partner and the LLP. The guidance above applies equally when accounting for LPs/LLPs as when accounting for other forms of JVs.

F

Intellectual property rights

Types of IPR?

F.1 The key types of UK IPRs are:

- Patents - available for new inventions relating to most industrially applicable processes and products. An application for a patent to be registered must be filed before the invention is publicly disclosed; indeed prior public disclosure or publication will prevent a patent from being granted.
- Copyright - a right which protects literary, dramatic, musical or artistic works, sound recordings, films, broadcasts, cable programmes and typographical arrangements from being wholly or substantially copied. The subject matter must be original and recorded in some way. Copyright arises automatically and so there is no requirement for the copyright to be registered in the UK.
- Designs – where a design is new and has individual character, the shape, configuration, pattern or ornament applied to an article may be protected by registering the design at the Designs Registry or, if not registered, by virtue of the unregistered design right.
- Trademarks - distinctive signs in the form of words, logos, colours, shapes, sounds and even smells which can be graphically recorded may be registered as trademarks to protect the way a supplier represents his goods and services. Unregistered trademarks and branding such as the look and feel or general “get up” of a product or its packaging can be protected by the law of passing off which does not require the packaging or product to be registered.
- Database rights – the right to prevent extraction or re-use of the whole or a substantial part of the data contained in a database in the production of which a significant amount of time and/or money has been invested.

F.2 The periods of protection for each of these rights vary greatly.

F.3 Not all intellectual or intangible assets can be protected by IPRs. Confidential know-how and expertise are often an important asset within the public sector, but one which cannot be protected directly as specific IPRs. Contributing know-how to a JV is potentially risky as there is a danger that the know-how will be leaked by the JV partner. The public sector body will therefore have to ensure that any such information is disclosed under strict obligations of confidentiality and enforce these obligations to retain their value.

F.4 Intellectual property rights in other relevant jurisdictions may also need to be considered.

Ownership issues

F.5 The public sector body must determine its ownership rights in the existing IPRs. For example, does the inventor of the patent have certain rights over the patent? If so, how are these to be dealt with? Could the copyright be Crown Copyright, in which case the appropriate

consents will need to be obtained from HMSO? All these issues will need to be tackled very early on in the process of setting up a JV entity, preferably when preparing the OBC.

F.6 If the public sector body is a licensee and the IPRs are owned by a third party, it will need to establish exactly what rights it has to make the IPRs available to the JV. This will depend upon the terms of its licence, which will need to be checked to determine whether the public sector body can assign the licence to the JV or grant a sub-licence to the JV. If the licence prohibits either of these options, the public sector body needs to decide if those rights are needed for the JV to carry on business and if this is the case the public sector must re-negotiate the terms of the licence with the IPR owner.

Other IPR Rights

F.7 The public sector body should also identify if there are other IPR rights which are needed by the JV. In some cases these may be contributed by the private sector participant; in other cases a licence may be required from a third party.

Procedures for dealing with future IPRs

F.8 The public sector body will need to clarify in the JV Agreement and/or IPR agreements the position in relation to new IPRs created in the future by either the JV, the public sector body or any of the JV partners in connection with the JV.

Future IPRs created by the JV: The options are set out in the Table F.1 below.

Table F.1: Options for ownership of IPR

| Options | Comments |
|-----------------------------------|--|
| Owned by the JV | Does the public sector body or any other shareholder want a right to use IPRs in particular sectors? What will be the terms of the licence to use? If not possible to agree terms now, should public sector/other shareholders have an option to call for a licence? What is to happen to the IPR/licence to use on any winding up of the JV? |
| Owned jointly by the shareholders | In the UK IPRs can be jointly owned. This is not the case in all jurisdictions. Unless joint owners have set out express obligations in relation to the IPR, a joint owner can only use and exploit the IPR in the course of its own business. There is no right to exploit the IPR through third parties. If joint ownership is chosen, suitable cross licensing provisions will need to be drafted between all the shareholders to deal with exploitation rights and maintaining the IPRs. This option is potentially complicated and should be avoided if possible. |
| Owned by one of the shareholders | The JV will need a licence to use the IPRs Will any of the other shareholders be able to use the IPRs? If so under what terms? What will be the position if the owning shareholder leaves the JV? |

Future IPRs created by a shareholder: If a shareholder creates IPRs which are relevant to the JV, consideration will be needed on how these IPRs will be made available to the JV, whether the IPRs should be licensed to the JV and if so on what terms, or whether the JV should have an option to acquire the rights. This may vary depending on whether the new IPR is created on the back of the existing IPR or not.

Calculating the value of the IPR contribution

F.9 This is a very complicated area, and appropriate advisers may need to be involved to (a) value, where feasible, the public sector body's IPR contribution, and where not, to give as good an idea as possible of the worth of the IPR; or (b) structure the to ensure that the public sector obtains the appropriate value for its IPR contribution.

F.10 Three common methods for the valuation of IPRs are the Cost Approach, the Market Approach and the Net Present Value or Income Approach. Each of these methods is described in further detail in the table F.2 below.

Table F.2: Pros and cons of IPR valuation methods

| | The Cost Approach | The Market Approach | The Net Present Value (NPV) or Income Approach |
|----------------------------------|--|---|--|
| Method of valuation | Assumes that there is a correlation between commercial value of intellectual property and the cost of its research and development (R&D), taking into account the costs of R&D, promotion, and depreciation/ appreciation. | Arrives at a market price for the intellectual property in question, based on comparable IPR currently or recently transferred in the open market. | Estimates the economic benefit that might derive from the IP during the protection period, less the input costs and other quantifiable calculated risks. |
| Pros | Very simple to calculate. | In theory, relatively easy to calculate provided that a suitable comparator exists. | Closest method to reflecting true potential of certain IPRs, notably patents. Can adapt to the amount of protection offered by different forms of IPR protection. |
| Cons | The commercial value of IPR does not necessarily correlate with the input costs. For example, a trademark may cost almost nothing to create but have huge consumer recognition and be extremely valuable. | There is often no suitable comparator available because of the unique nature of IPR. Further, details of valuations used are very rarely made public. | Complex calculation. Requires considerable background data Produces subjective valuation. |
| Likely to be suitable for | copyright, design right (registered or unregistered). | trademarks (because generally more comparators), copyright (but only if a reasonable comparable is available). | patents (most suitable approach), trademarks. |

G

Direct tax issues

| | Limited Company | Limited Liability Partnership and Limited Partnership |
|---|---|---|
| ESTABLISHING THE VEHICLE | | |
| Shareholder/partner financing of Special Purpose Vehicle (SPV) | Where JV Co is financed by way of debt, consideration should be given as to whether interest incurred by JV Co is tax deductible. For example, an interest deduction may not be available if the debt instrument used is considered equity for UK tax purposes or not lent down on arm's-length terms. Specialist advice should be sought on this if appropriate. A UK corporate shareholder is likely to be taxable on the corresponding receipt of interest. | Same issues as for a limited company. |
| Transferring property to SPV | <p>Any transfer of property from a taxpaying shareholder to JV Co is likely to give rise to direct tax issues. For example, the transfer of a building to JV Co may result in a capital gains liability for the shareholder, or a balancing charge for capital allowance (tax depreciation) purposes. The nature of the issues will depend on the property being transferred, the use to which the property is intended to be put and the tax profile of the shareholder.</p> <p>The purchase price paid for property or assets may have to be apportioned to individual assets which could affect the tax allowances available (e.g. allocated to plant and machinery rather than land and buildings).</p> | Same issues as for a limited company. |
| OPERATIONAL ISSUES | | |
| Basis of taxation | Profits are subject to corporation tax in the company at the JV Co's marginal rate. Distributions to shareholders by way of dividend should not be taxable on UK corporate or public sector recipients. | LLPs and LPs are transparent for tax purposes, so taxable profits are attributed directly to the partners/members. Whether tax is payable on the partnership's profits will depend upon the tax profile/status of the partners/members. |
| SPV's tax status | The direct tax treatment of JV Co will turn on whether it is a trading company or an investment company. This status will determine: under what 'schedule' income is taxed; whether | Same issues for corporate partners/members as would arise in a limited company. |

| | Limited Company | Limited Liability Partnership and Limited Partnership |
|---------------------------------------|--|--|
| | certain expenditure is capital or revenue for tax purposes; and what tax reliefs are available. | |
| Tax rate | JV Co will be subject to UK corporation tax. The mainstream rate of corporation tax is currently 28% but lower rates may apply in the case of some smaller companies. | As stated above, profits are attributed directly to the partners/members. Corporate partners/members, regardless of residence, will be subject to UK corporation tax on those profits as normal. |
| Impact of accounting treatment | While JV Co's accounting policies will be taken into account in determining whether certain expenditure is treated as capital or revenue for tax purposes and the timing of tax relief for revenue expenditure, the issue of whether expenditure is treated as capital or revenue is ultimately a question of law. JV Co's accounting profits are unlikely to equal its tax profits due to permanent differences (non-deductible expenditure) and timing differences (e.g. where capital allowances do not equal accounting depreciation). | Same issues for partners/members as for a limited company. |
| Capital allowances | A number of issues may arise in relation to capital allowance claims in respect of JV Co's eligible assets. The issues will hinge on the nature of the property and the interest held in it by JV Co. | Same issues for partners/members as for a limited company. |
| Tax losses | Trading losses can be used in a number of ways by JV Co, including surrender to corporates by way of group relief or consortium relief. Non-trading losses can also be used in a number of ways including surrender to corporates by way of group relief. However, depending upon the exact nature of the company's trade/business, there can be a restriction on the surrender of losses by way of consortium relief. | Partners/members obtain their share of losses according to ownership percentages. Utilisation of losses can be restricted to the amount of capital contributed to the partnership less amounts withdrawn (plus, potentially retained profits). Where utilisation is not possible, the losses are carried forward in the partnership. |
| Capital gains | Capital gains or losses may be generated by JV Co when it disposes of capital assets. Advice may be required to ensure that JV Co claims all relevant reliefs. | Capital gains or losses may be generated by the partnership when it disposes of capital assets. These gains or losses are attributed directly to the partners/members. As for a limited company, advice may be required to ensure that all relevant reliefs are claimed. The capital gains tax legislation surrounding the admission/exit of partners/members can be complex. It may be possible to avoid accelerating the tax liabilities of continuing partners/members but it is strongly recommended that specialist advice is sought |

| | Limited Company | Limited Liability Partnership and Limited Partnership |
|-------------------------------------|---|---|
| | | in this area. |
| Withholding tax | Payments by JV Co, especially interest and royalties for the use of intellectual property, may be subject to withholding tax although generally this does not apply for payments to UK companies. Where these payments are being made to non-residents the withholding tax liability may be reduced under a double tax agreement. | Same issues as for a limited company. |
| SHAREHOLDER / PARTNER ISSUES | | |
| Tax status | The public sector shareholder's tax status will vary from case to case and should be fully understood when structuring JV Co. | Same issue as for a limited company. Specifically, it will need to be understood whether the carrying on of activity through the LLP/LP will constitute a taxable activity for the public sector body. |
| Profit extraction | Taxation of distributions from the JV will need to be considered. Generally receipt of a dividend by a UK resident corporate or public sector shareholder will not be a taxable receipt. | Not applicable as profits are attributed directly to the partners/members. The income and gains of the LLP/LP are attributed to the partners/members as they arise and there is no further tax payable by the partners/members as and when the profits are distributed. |
| Residency | If the private sector shareholder is not a UK tax resident a number of international tax issues may need consideration. For example, particular care will be required where payments are to be made by JV Co to the non-resident shareholder which may be subject to UK withholding tax. Transfer pricing rules are also likely to be relevant. | Similar issues as for a limited company. |
| Loss relief | Shareholders may, depending on their own tax profile, wish to ensure that they have access to losses incurred by JV Co. In order to achieve this care will have to be taken to ensure that the group relief or consortium relief rules can be utilised. | Whilst losses are directly attributed to the partners/members, there are restrictions on whether these can be utilised as stated above. |
| Exit strategies | Alternative exit strategies for JV shareholders will need to be considered from a tax perspective when the structure is being planned. This will require a full understanding of the type of investor likely to become a shareholder in the JV and the tax profile of the particular investor. | The capital gains tax legislation surrounding the admission/exit of partners/members can be complex. It may be possible to avoid accelerating the tax liabilities of continuing partners but it is strongly recommended that specialist advice is sought in this area. |



Exit strategies

Voluntary sale of shares/Partnership capital

H.1 The voluntary sale of shares/partnership capital is likely to be the main way of extracting value from the JV (distributions and licensing fees/royalty payments being the other main ways). The strategy for selling the shares/capital and realising value should therefore be considered in detail when forming the JV.

H.2 Participations can be sold to other existing participants or third parties in a variety of ways (either a sale of part or all the participation held by one party), including trade sale or the flotation of all or part of a JV.

H.3 As the JV has been set up by agreement of at least two parties for a specific purpose, it is important to have a degree of control over the ability of either party to sell their respective participations. It is usual to include in the JV Agreement (or in the case of a company limited by shares, the Articles of Association) specific principles that may prevent a party from selling its equity interest or may restrict a party's ability to sell that interest to an unknown third party. It is commonly the case that some form of pre-emption mechanism is in place allowing the option for the non-exiting party to acquire the shares/partnership interest of a party requiring a voluntary exit.

Voluntary winding up

H.4 In some cases participants may all agree to exit the JV by winding up the JV. This may occur where, e.g., the objectives of the JV have been achieved or the underlying rationale for setting up the JV no longer exists.

H.5 The JV Agreement may include detailed provisions stipulating a particular procedure to apply to the disposal or break up of the JV's assets (e.g. a compulsory auction of its assets) together with any ongoing provisions as to confidentiality or restrictive covenants which should continue following the winding up of the entity.

Compulsory sale of shares/partnership capital or winding up

H.6 The participants need to agree whether there are circumstances or default events which may trigger:

- the right of one party to compel the other party (usually a defaulting party though not always) to sell its shares; or
- the JV to be wound up.

H.7 Table H1 sets out a few examples of the type of trigger events which the participants may wish to consider. It is not intended to be a complete list.

Table H.1: Trigger events

| Event | Consequence | Comments |
|-------------------------------------|--|--|
| Material default by one party | Right to compel the defaulting party to offer its equity interest for sale (usually to the non-defaulting party under pre-emption rights). | Default events include a material breach of the JV Agreement (usually a breach which is incapable of remedy) or possibly of any other agreement (such as subsidiary contracts) or failure by the private sector party to inject capital into the JV. |
| Insolvency of a JV partner | Right to purchase insolvent party's equity interest through a "call option." | This default event will only apply to a private sector party. Definition of "insolvency" to be carefully drafted and may need to include parent companies. The mechanism for valuing the share price will also need to be considered. |
| Change of control of a JV partner | Option to require the party which is subject to a change of control to sell its participation or buy the participation of the other party. | This default event will normally only apply to a private sector party. Need a sensible definition of "change of control", this mechanism allows the party who has not been the subject of a change of control to determine whether or not to continue the JV, and if not on its own terms. |
| End of licence or end of purpose | Right to compel the JV's winding up. | Useful where an entity has been set up for a specific purpose which has ended or where a regulatory licence has been revoked. |
| Invalid transfer of equity interest | Provisions which enable the transfer not to be effective and to provide for compulsory purchase of a participation. | This is important to prevent a party from benefiting from acting outside the provisions set out in the JV Agreement or, in the case of a JV, the Articles of Association in relation to transferring shares. |

H.8 In addition to a specified default event, it will always be open to a participant to apply for a court order compelling the winding up of the JV on the grounds that this would be "just and equitable" under the terms of the Insolvency Act 1986 (or equivalent for LLPs).

Mechanisms related to the sale of joint venture shares

| Mechanism | Explanation | Comments |
|---|--|--|
| Lock in period | Prohibition on a party from selling its shares for a specified period. | To ensure that an important partner stays involved and to incentivise the party to achieve the objectives of the JV. |
| Consent of other participants not to be unreasonably withheld | Prohibition on a party from selling its participation without the consent of all other participants not to be unreasonably withheld. | Where the participation of the private sector party is considered critical, this could be a compromise to a lock-in period. It is important to question whether a party who is refused consent to sell will still be willing to contribute to the JV, or whether they will feel aggrieved; the mechanism is therefore sometimes linked to a winding up provision if the sale of shares is refused. |
| Approval of Board | Any transfer to be subject to approval of the Board. | This mechanism may favour a sale by a majority participant who has greater board representation than a minority participant. |
| Put and call options | Where a party may have an option to require the other party to buy or sell its participation. The option for a compulsory transfer could be exercisable at will or on a trigger event depending upon how the participants have structured the JV. | This option can enable a party to require the other party to sell or buy its participation. As these provisions may force an unwilling buyer/seller, they may not be appropriate for a JV. They may be a useful mechanism for minority participants to prevent a lock in. |
| Pre-emption rights | Any participation for sale must first be offered to the other participants in accordance with agreed procedures and a participation valuation mechanism to prevent opportunistic pricing by the exiting party. | This standard provision is a useful mechanism for the remaining party to consolidate control (subject to being able to raise the cash for the participation and any classification consequence). |
| Intra-group transfers | Allows members to transfer participations to other companies within a group of companies. | A fairly standard mechanism. It is important to define carefully the parties who are in the "group" e.g. is it a "wholly owned subsidiary" or any subsidiary (or equivalent partnership interests) |
| Piggy back | Variation to pre-emption rights mechanism which allows a party to sell its participation to a third party provided that if the remaining participants wish, the third party buyer also buys the entire equity interests of the other participants. | This is a useful mechanism for a minority participant who may wish to sell out where its partner has found a buyer. The effect of this clause is that it is the sale of the entire the entire JV to a third party. Consideration will need to be given to the status of any subsidiary contracts. |
| Drag along | Where a party (generally a majority participant) is permitted to sell its participation to a third party it can also force its JV | The rationale for this mechanism is that a business is far more saleable where it is a sale in its entirety or of a majority of participations sufficient to give buyer |

| Mechanism | Explanation | Comments |
|--------------------|---|--|
| | partners to sell their participations to the same third party. | effective control. The effect of this provision is that it is the sale of the entire JV to a third party. |
| Tag along | A minority participant can force a sale of its participation to a third party buyer of a majority equity interest at the same price. | This mechanism provides an exit route for a minority participant so that it does not find itself in a JV with a completely different JV partner. Tag along and drag along provisions usually go together. They need to be treated with caution in JVs focused on long-term partnership and not simply about investment and realisation of an investment. |
| "Russian roulette" | Halfway between a voluntary and compulsory exit, this mechanism allows a party wishing to exit a JV at any time to offer its participation for sale to the other party. If the other party rejects the offer to buy, it must offer its own participation to the original seller upon the same terms. | This mechanism can only be used where the parties are on an equal footing. It cannot work where one party is weaker in its ability to buy participations (e.g. because of funding constraints), as the party forcing the issue may take advantage of this to force a sale of participations by the other party. Given that this method makes it difficult to prove VfM, it does not seem appropriate to a public-private JV. |
| "Texas shoot out" | A variant of Russian roulette where one party applies to buy the other party's participation. If this offer to buy is rejected, a counter offer for the purchase of the "buyers" participation must be given at a higher offer. Then the parties may go to sealed bids with a sale to the highest bidder. | This is more akin to form of compulsory transfer. As with Russian roulette, a mechanism where the price paid for the shares is not open to scrutiny is unlikely to be appropriate to a public-private JV. |



Factors supporting the use of a joint venture

| Factor | Areas of Evaluation |
|-----------------------------|---|
| Purpose | Project relates to value capture, route to market or a long-term programme. |
| Business need | The outcomes are unable to be delivered efficiently and/or effectively when the parties are acting independently. |
| Complementary objectives | The public and private sector parties have complementary objectives and skills and each has a contribution to make to deliver outcomes successfully. |
| Shared risks and rewards | Where the public sector prefers to share the risks of developing and rolling out the JV business (in return for sharing the rewards) rather than bearing them all itself |
| Corporate entity governance | The project would benefit from the sort of formalised and well understood governance system inherent in the creation of a corporate entity. A JV structure encourages greater focus on achievement of a jointly agreed business plan, achieving goals and direct accountability for the performance of a JV's business. |
| Management and control | The public sector wishes to gain benefits from sharing management responsibility for the work, and that the introduction of additional participants over time is desirable. Where appropriate, it is possible for public policy objectives to be preserved by securing the desired level of control in the decision making of the JV at both participant and management levels. |
| Separate legal identity | Desirability for the creation of an entity with its own legal capacity, ⁹³ separate from its founder participants, so that the JV can: own and deal in assets; employ people; enter into contracts in its own right and; if it is classified to the private sector, work outside of some of the specific limitations and constraints of public sector budgeting and framework controls. These features need to be balanced against issues such as insolvency legislation, directors' liabilities (where the JV is a company) and wider implications for the public sector body such as public accountability, ministerial responsibilities and audit requirements. |
| Access to finance | A JV structure is an effective medium for securing investment and funding or otherwise raising finance from private sector sources. |
| Flexibility | There is a need for flexibility, e.g. when the detailed objectives and the means by which they are best delivered cannot effectively be fixed at the outset. Examples include where required outputs (such as quality and volume of the services needed), or the way in which the objectives can best be delivered (perhaps as a result of technology advancements or by new policy targets and standards), are likely to change over time. |
| Clear exit strategy | The realisation of value created by the public sector and other participants can be released through the exit arrangements available in JVs. |
| Retain profits | Public sector wishes to have the option to retain profits in the JV entity to fund research and development or business growth so that the participants realise capital growth only when they sell some or all of their equity interest in the JV. |
| Access to skills | Public sector wishes to improve access to the skills and other resources of the private sector participant(s); the private sector participant will be motivated to make the better resources available as it will benefit from the profits arising in the JV. |
| Incentives | Public sector wishes to give staff greater incentives to deliver, through the prospects of higher salaries and rewards such as bonuses or share options. |
| Branding | Public sector wishes to brand/market a product or service which is seen as being separate from the core public sector activities of the public sector participant. |

⁹³ Save in the case of a limited partnership where contractual relationships are undertaken through the general partner.

K

Further competition law issues for joint ventures

Major provisions

K.1 The two main aspects of competition law to be considered when setting up the JV are:

- merger control (under the 2002 Enterprise Act and the EC Merger Regulation); and
- anti-competitive agreements (the Section I prohibition of the 1998 Competition Act, and Article 81 of the EC Treaty).

K.2 The other aspect of competition law, abuse of a dominant position in a market, may also be relevant after the JV has been set up, particularly if the activities of the JV are in a niche or uncompetitive area.

Merger control

K.3 The formation of a JV entity may constitute a “relevant merger situation” under the UK’s Enterprise Act, if two or more “enterprises” cease to be distinct. This may occur if two or more of the JV’s founders allocate part of their assets, business, IP rights or personnel to the JV. There is no obligation to notify such a “merger” to the OFT. However, the OFT may investigate a JV entity agreement if it feels that it may have an anti-competitive effect. It will only however, investigate a JV which satisfies either of the following tests:

- where the JV will supply or acquire at least 25% of all particular goods or services in the UK, or part thereof, and at least two parties to the JV supply or acquire the particular goods or services (the share of supply test); or
- where the annual value of the UK turnover of two or more of the “enterprises ceasing to be distinct” exceeds £70m (the turnover test).

K.4 The EC Merger Regulation (ECMR) may apply if the JV is a “full-function JV” (i.e. if it performs on a lasting basis all the functions of an autonomous economic entity, which is likely to be the case for JV companies covered by this Guidance) and is sufficiently large-scale to merit investigation (the thresholds for investigation include a worldwide turnover of the JV partners having to exceed 5 billion euros).⁹⁴ However, if each of the partners achieves more than two-thirds of their aggregate turnover within the UK, then the ECMR rules will not apply.

K.5 This means that most JVs entered into between public and private partners are likely to avoid EC scrutiny as mergers.

Anti-competitive agreements

K.6 A JV may constitute an anti-competitive agreement⁹⁵, if it can be judged to have an appreciable effect on competition. In general, although much will turn on the likely economic

⁹⁴ There is a second, lower threshold of 2.5 billion euros, which applies if certain conditions are met.

⁹⁵ A JV agreement will normally only be assessed as an “agreement” if it is not a “merger” for the purposes of the Enterprise Act or the ECMR (regardless of whether the “merger” needs to be notified).

effects the agreement in question, a JV agreement is unlikely to be judged to have an appreciable effect on competition (and therefore is unlikely to infringe competition law) if the JV entity's share of the relevant market is less than 10%.

K.7 Where the JV's share of the relevant market is in excess of 10%, the JV agreement may still be exempted from the UK and EC provisions against anti-competitive agreements. There is an exemption for research and development (R&D), e.g., which seeks to encourage co-operation in R&D, although a competition authority investigating a JV arrangement would typically be concerned to ensure that such arrangements do not unduly prejudice potential competition in the future (particularly if the arrangements extend to joint production and/or exploitation). The JV's founders will need to consult their advisors and "self-assess" the JV agreement for compliance with competition law as it is no longer possible to notify proposed agreements to the relevant competition authority in order to gain advance clearance.⁹⁶

⁹⁶ OFT Guidance www.oft.gov.uk/advice_and_resources/publications/guidance/competition-act.

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This document can be found in full on our website at:
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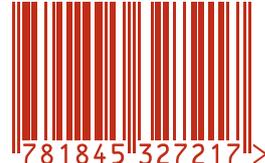
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