

GREAT FUND INSIGHTS

Joint venture funds in the Middle East market: a model of collaborative investing

We are seeing increasing interest in joint venture funds in the Middle East region as a model of collaborative investing as investor types are multiplying and looking globally for investment opportunities and greater alignment with managers. Investors such as sovereign wealth funds (SWFs), pension funds and family offices are seeking innovative strategic partnerships to put their capital to work with either other institutional investors, investment managers, banks and/or specialised operating companies. Also, managers are looking to collaborate with other managers that have a particular expertise in order to expand their product range. These joint venture funds are being established across asset classes (including infrastructure, real estate, private equity and technology) as well as across

geographies (eg MENA and sub-Saharan Africa and by way of country-specific funds). An recent example is CDC International Capital (a subsidiary of the Caisse des Dépôts et Consignations) and Kingdom Holding Company on the establishment of a Saudi joint venture private equity fund to invest in Saudi projects and ventures.

Joint venture funds present some unique challenges as each is bespoke, including in terms of structuring the governance and termination arrangements, depending on the identity, role and level of equity participation and involvement of the co-sponsors, as well as what they bring to the table in terms of added value (eg deal origination, expertise and local network etc). This article discusses some of the issues to be considered in the context of structuring such arrangements.

Structuring considerations

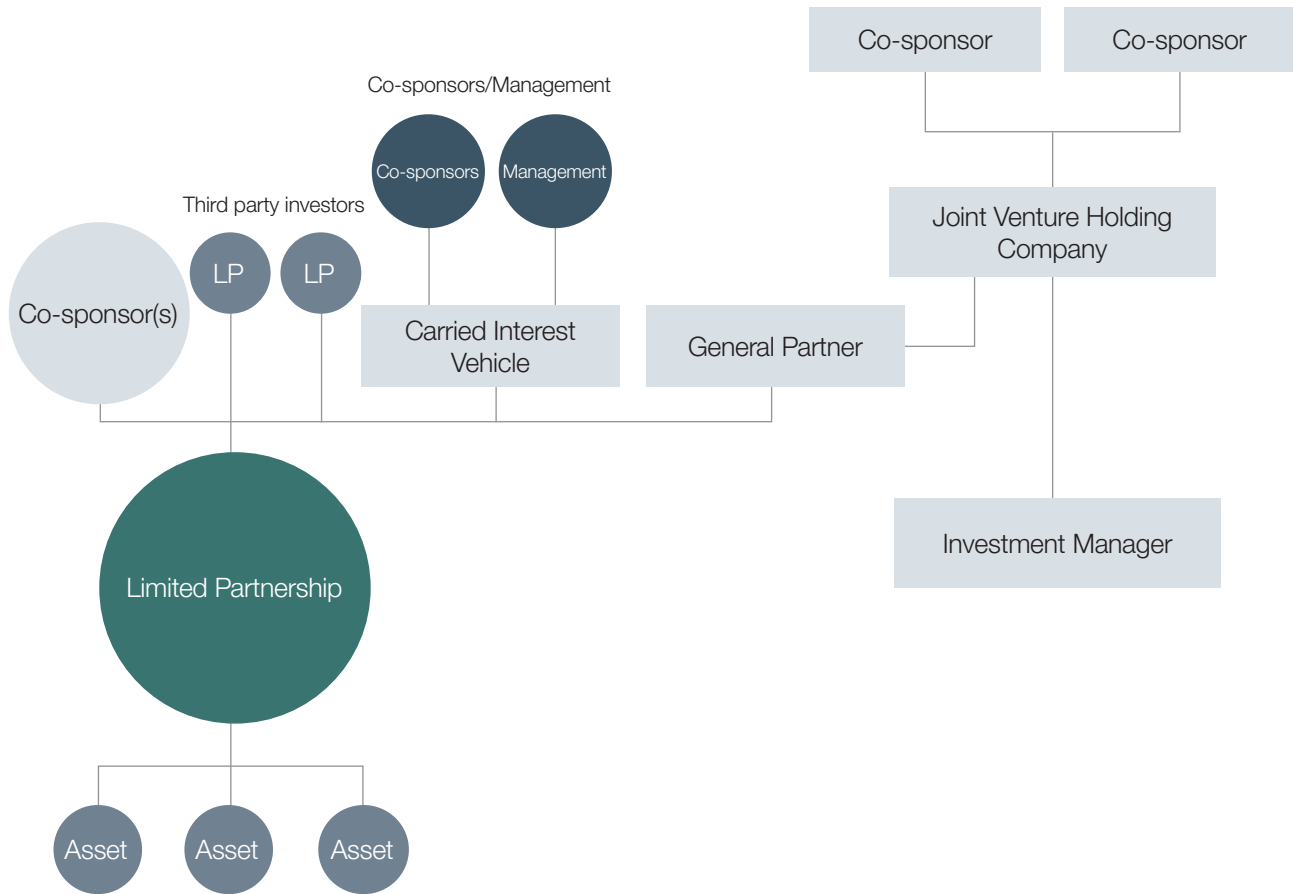
Similarly to many other funds, the factors that impact structuring a joint venture fund include:



The jurisdictions of incorporation for these funds in the Middle East market include the regional financial centres (eg the Dubai International Financial Centre and the Abu Dhabi Global Market), the Cayman Islands, Luxembourg and Mauritius. We are also seeing such joint venture funds being established in certain circumstances under local laws (eg Saudi Arabia), particularly where the fund has a single country focus.

Example of a joint venture fund structure

An example of a joint venture fund structure is as follows:



Governance

Given the multiple parties involved and their differing interests in the structure, it is important to ensure that an appropriate balance is achieved between the oversight/checks and controls of the co-sponsors versus an effective and empowered management team to manage the fund. The parties need to focus on clearly defining the role and composition of the board of directors of the general partner and/or investment manager and the investment committee. It is also important that the list of the reserved matters for the shareholders and the board of the general partner and/or investment manager are clearly defined in the documentation. For example, will the members of the board of directors and the investment committee overlap? Will the board of directors have the ability to review and veto an investment decision?

Examples of board reserved matters in relation to a joint venture fund include:

- amendments to the constitutional documents of the fund and its related entities including its investment strategy;

- extending or terminating the investment period and/or the term;
- entering into any transaction which is unusual or outside the ordinary course of business;
- applying for a licence, registration or authorisation relating to the conduct of the business of the fund in any jurisdiction;
- payment from the fund's assets for expenses over a specified threshold;
- undertaking any major corporate transaction (eg any merger, reorganisation or IPO); and
- changing the auditors, accounting standard and practices or tax policies of the fund.

They may also include a catch-all in relation to any matters that are to be approved by, or to be determined at the discretion of, the general partner and/or the investment manager under the constitutional documents of the fund.

Conflicts of interest

Consideration needs to be given in particular to conflicts of interest in the context of a joint venture fund, taking into account the dynamics between the co-sponsors:

- **Exclusivity and priority:** The limited partnership agreement (LPA) will typically contain provisions requiring the co-sponsors to offer suitable investment opportunities sourced by them to the fund before offering the opportunity to their other managed funds and/or accounts. These provisions require particular care in the context of a joint venture where, for example, only one of the co-sponsors has access to such investment opportunities and how the impact of breach of such obligation by such co-sponsor vis-à-vis the non-defaulting sponsor is to be treated.
- **Competing funds:** The LPA may contain provisions preventing the co-sponsors from establishing competing funds with the same or substantially similar investment objectives until the end of the investment period of the fund and/or all or substantially all of the fund's commitments have been deployed. Thought needs to be given to this in the context of a joint venture fund, particularly where only one of the co-sponsors is raising competing funds and the impact of breach of such obligation by such co-sponsor vis-à-vis the non-defaulting sponsor.
- **Transaction with affiliates, transaction fees and offset:** The LPA will typically include provisions on affiliated transactions between the co-sponsors and/or their

affiliates on the one hand and the fund and/or its portfolio companies on the other hand. This is exacerbated in the context of a joint venture fund where a co-sponsor may have a particular expertise and, accordingly, provide services to the fund and/or its portfolio companies.

The co-sponsor that is not providing these services will typically require that affiliate transactions be a board reserved matter in order to approve the provision of such services. Also, limited partners typically require a rebate of all, or a specified portion, of any transaction fee (ie a dollar-for-dollar adjustment) against the management fee. The co-sponsor that does not have the benefit of such a transaction fee will want to ensure that equitable sharing arrangements are put in place at the manager level in relation to the management fee to reflect this rebate.

- **Key person event:** The operation of the fund may be tied to the presence of certain individuals in the management team who have certain skills, expertise and network and who are accordingly deemed to be “key persons”. In the context of a joint venture fund, there may be particular time commitment undertakings by the co-sponsors' key persons and, where a key person event is attributable to a key person connected to just one of the co-sponsors, consideration needs to be given to whether the non-defaulting sponsor should have the right to step in, remove and appoint a replacement key person in order for the investment period to be resumed.

Exit

It is also important to address from the outset the impact of an exit on the joint venture fund and the joint venture investment manager and the interlinkages/touch points between them.

With respect to a voluntary exit, unlike typical corporate joint ventures which have a lock-up period and transfer restrictions post-lock-up, we may see a prohibition on transfers other than to affiliates at the investment manager and the fund level in order to seek to ensure that the parties are focused on the joint venture fund during its term.

With respect to an involuntary exit (ie where the exit is compulsory), care needs to be given to address the impact that the following termination events under the LPA has in respect of the fund and fund-related entities:

- **Removal for Cause:** The LPA may have contain an early termination event that allows limited partners (typically by way of a majority vote) to remove and replace the general partner and investment manager and/or elect to terminate the fund. The definition of “Cause” is heavily negotiated but will typically include at a minimum fraud, gross negligence and wilful default.
- **Not for Cause removal:** The LPA may contain provisions permitting limited partners (typically by way of a super

majority vote – often requiring 75% or more of the total commitments in the fund) to remove and replace the general partner and investment manager, to terminate the investment period and/or to terminate the fund.

- **Events of default under the LPA:** Examples include:
 - a serious or persistent unremedied breach of the LPA by a co-sponsor;
 - bad faith, professional misconduct, recklessness or gross negligence of a co-sponsor in connection with the operation of the fund;
 - a co-sponsor engaging in fraud or wilful misconduct or committing a wilful illegal act;
 - any judgment, arbitration award or determination by the relevant regulatory authority of a competent jurisdiction against a co-sponsor which affects its ability to carry out its duties under the LPA; and
 - an injunction against a co-sponsor from engaging in or continuing any conduct in connection with the fund.
- **Fund dissolution:** The LPA will typically include the dissolution of the fund as a termination event.

The consequences of termination need to be carefully considered, in particular where such event is attributable solely to the action of a co-sponsor, its affiliates and/or its nominated representatives to the board of directors of the investment manager and/or the investment committee. Consequences may include:



Conclusion

The interaction between the joint venture arrangements and the fund documentation needs to be carefully structured from the outset, taking into account the dynamics between the co-sponsors, the management team and the investors to ensure that an effective structure is put in place to enable the future success of the joint venture fund.



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