



## CONTRACTUAL JOINT VENTURES: PRACTICAL THOUGHTS FOR FOREIGN COMPANIES OPERATING IN THE GULF REGION<sup>1</sup>

The contractual joint venture is the natural option when there is a need for several companies to team up together, on a temporary basis, to deliver a specific project without establishing a company.

Such a contractual cooperation is a way to share the risks associated with a capital project and the financial burden of the related project bonds which may be very significant. From a commercial perspective, the contractual joint venture offers more flexibility than the incorporated joint venture which will tie-up two or more companies on a more permanent basis as equity partners<sup>2</sup>.

Such an option is very often available in the countries of the GCC but of course, this is not always the case as this will ultimately depend on the client and on the nature of the project at stake<sup>3</sup>.

Finally, as we will further elaborate below, the fact that a foreign company enters into a contractual joint venture agreement will not dispense such company from complying with the rules regulating foreign investment in the relevant jurisdiction.

### ***What are contractual joint ventures used for?***

Contractual joint ventures are very commonly used in the field of oil & gas (EPC, project development or joint operation agreements), construction & infrastructure (design-and-build agreements) but also consultancy services (such as major event management or transaction advisory services)<sup>4</sup>.

The projects at stake are generally large ones, often tendered according to the relevant public procurement law applying to the employer<sup>5</sup>.

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<sup>1</sup> Gulf countries generally refer to the countries which are members of the Gulf Cooperation Council (GCC), a regional organization. The GCC is composed of the Kingdom of Saudi Arabia (KSA), Kuwait, Bahrain, Qatar, the United Arab Emirates (UAE) and Oman. We will focus in this paper on KSA, the UAE and Qatar. It should be mentioned that Iraq and Iran are the two other countries having access to the Gulf ("Al Khaleej" in Arabic). Yemen is part of the Gulf peninsula; however, it does not have access to the Gulf but rather to the Indian Ocean and to the Red Sea.

<sup>2</sup> For example, a company A may prefer to team up with a company B on a given project, while it will prefer to cooperate with a company C on another one.

<sup>3</sup> For example, an employer may request a group of bidders to set up an incorporated joint venture to deliver a project. Besides, certain transactions such as PPP projects require a special purpose (incorporated) vehicle to be set up for structuring and financing reasons. Whilst it is anticipated PPP projects will become more commonplace in the GCC, most capital projects until recently have been financed through State budget and therefore have not required a project-finance type of structuring.

<sup>4</sup> It is quite common on larger projects for employers to appoint a transaction advisory team which will typically be composed of a technical advisor, of a financial advisor and of a legal advisor, who will together advise the client on the financial model and on the legal documents required to tender a major project on the market, to negotiate a complex contract and then to close the deal with the winning bidder.

<sup>5</sup> Although it should be mentioned that it is also quite common for major projects in the GCC to be tendered through commercial subsidiaries of State entities, thus being submitted to private rules of law (the Doha metro project is a case in point, as Qatar Rail, the employer on such project, was set up as a commercial company whose equity is ultimately owned by the State).

They are usually preceded by joint bidding agreements<sup>6</sup>, which will set the principles according to which several companies will bid together on a major project<sup>7</sup>; the final joint venture agreement will typically be finalized once a group of companies has been designated as the preferred bidder or has been formally awarded the contract.

Practice tends to make a distinction between the unincorporated joint venture (UJV) where several parties, who are usually competitors in the same area of business, team up to deliver a large scope of work which is split between them<sup>8</sup> and the consortium agreement, where each member, each having its own skillset, is responsible for a delineated scope of work<sup>9</sup>.

Several foreign companies may team up together to deliver a project under a UJV or a consortium, although it is quite common in public tenders for the employer to request bidding teams to include at least one local company<sup>10</sup>.

There is generally no legal definition of what a joint venture is under the laws of GCC countries<sup>11</sup>; general principles of contract law and corporate law will be used to draft and interpret such contracts.

While a UJV or a consortium agreement is a *sui generis* contract, where there is a large degree of contract freedom, it would be wrong to assume that local laws of the jurisdiction where the project is being delivered should not be taken into account, as will be further explained below.

### ***Contractual joint venture vs incorporated joint venture***

As the name suggests, a joint venture is said to be “contractual” so as to make a distinction with the “incorporated” joint venture which is a company set-up and registered according to the statutory provisions of the law of the relevant jurisdiction<sup>12</sup>.

The incorporated joint venture will require a great deal of formalities, including legalized and translated documents coming from the foreign shareholder(s), the drafting of a shareholders’ agreement, the drafting and official signing of articles of association<sup>13</sup> and the obtaining of various licenses to be delivered by the relevant authorities<sup>14</sup>.

This is because the incorporated joint venture is a separate legal body, having a separate existence and purpose from that of its shareholders. An incorporated joint venture will also be required to prepare accounts, which will need to be audited and a tax declaration to be filed every year in the countries of the region where an income tax law applies (such as in KSA or in Qatar). Liquidation procedures will also be complex and quite cumbersome<sup>15</sup>.

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<sup>6</sup> Although it is also possible to draft one contract only dealing with the cooperation between the parties both at bidding stage and at contract implementation stage.

<sup>7</sup> Bidding costs can easily run into millions of dollars on certain major projects.

<sup>8</sup> For example, on a metro project, the design and construction of several kilometers of tunnels.

<sup>9</sup> For example, on a metro project, civil works on the one hand and the delivery of rolling stock and signaling equipment on the other hand.

<sup>10</sup> Instructions to Tenderers will usually contain sections dealing with how a group of companies may respond together to the tender, as opposed to the simple situation where there is a single bidder. Some tenders may be restricted to companies being already registered in the country (whether their equity is owned by locals only or by locals and foreigners together), although it is more common to see tenders open to international contractors not yet having a presence but who will need to commit to establishing a proper legal vehicle should they be awarded the project.

<sup>11</sup> This is the case under UAE law whilst KSA law contains some limited provisions relevant to contractual joint ventures in the Implementing Regulations of its public procurement law, as we will further elaborate later. Interestingly, Qatar’s commercial companies’ law contains some generic provisions on UJVs, on which we will expand below. By way of comparison, it should be noted that there is no definition of a joint venture under English law or French law as well (the “*groupement momentané d’entreprises*” being very much a creation of practice).

<sup>12</sup> Usually, the commercial companies’ law and/or the foreign investment law.

<sup>13</sup> Which will need to be in a bilingual English/Arabic version for the purpose of their registration.

<sup>14</sup> A company will exist from the date of issuance of a general commercial registration or license. In certain sectors such as engineering or construction, a special license or classification is often required as well. Other operational licenses (municipal license, immigration license) will also be necessary for the legal entity to be fully operational.

<sup>15</sup> Including appointing a liquidator, preparing liquidation accounts and obtaining a tax clearance in jurisdictions where an income tax law applies.

By contrast, the contractual joint venture will require much fewer formalities because it will not need to be registered, there will not be any articles of association in addition to the joint venture agreement and no separate license will need to be obtained.

However, each member of the joint venture shall of course comply with any applicable mandatory provision of local law in respect of its legal presence on the ground. If an economic activity needs to be carried out in the country where the project is being delivered, which is generally the case, a foreign company will need to have a local legal entity able to deliver the works or services at stake.

In practice, it means that a foreign company will need to set up a subsidiary which historically in GCC countries has meant the establishment of a 51/49 incorporated joint venture with a local partner<sup>16</sup>.

It should however be noted that foreign companies may have the option to set up foreign branches<sup>17</sup> while wholly foreign-owned subsidiaries outside of free zones are more and more commonplace in every country of the GCC<sup>18</sup>.

Therefore, it is quite common for the UJV or consortium agreement to assemble various forms of legal bodies: a local company<sup>19</sup>, a wholly owned subsidiary of a foreign company, a branch of a foreign company and/or an incorporated joint venture<sup>20</sup>.

When the joint venture enters into a contract (whether the main contract with the employer or contracts with suppliers, subcontractors or consultants), it will actually mean that each member of the joint venture has given a mandate to a joint representative allowed to sign such contract on behalf of each and every member taken individually.

Under a consortium agreement, each member is supposed to hire the subcontractors who are relevant for their own scope of work, unless the subcontractor's works or services are relevant for the whole project in which case the related costs can be shared.

Because the contractual joint venture is not a separate legal body, but simply the assembly of several independent companies, it will usually be transparent from a tax perspective. No separate tax registration will generally be required but each member of the contractual joint venture will be required to comply with their own tax obligations<sup>21</sup>.

### ***Usual clauses seen in consortium and joint venture agreements***

The clauses of a joint venture agreement will largely be similar to those of the shareholders' agreement with the notable exception that all the provisions relating to the establishment, registration or liquidation of a company will not be needed.

In particular, there will be no equity contribution but rather "participation shares" in the project. Defining the participation shares of the various members of the contractual joint venture is the most important feature of the agreement, because this repartition will dictate the allocation of profits and risks between the parties and the way the joint venture is being managed.

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<sup>16</sup> For example in the UAE, in order to be able to operate in Mainland UAE (i.e. everywhere except in certain free-zones which have their own regime), there has historically and until now been a requirement to set up an incorporated joint venture with a local partner holding at least 51% of the equity pursuant to Federal Law 2/2015 (which is the UAE Companies Law).

<sup>17</sup> Which can be a temporary branch (such as the project branch in Qatar or the temporary commercial registration in KSA) if in relation to one or more government contracts or a permanent branch (as is the case in the UAE).

<sup>18</sup> In the UAE, Federal Decree-Law 19/2018 aims at relaxing the 51/49 rule and at allowing foreign companies to set up subsidiaries without a local partner in a large array of sectors, although this reform is still not being effectively implemented yet. The same situation prevails in Qatar pending the issuance of the executive regulations of a new Foreign Investment Law 1/2019, although Qatar has already allowed, since 2010, foreign companies operating in certain priority sectors to apply for an exemption to set up a subsidiary without a local partner. KSA and Bahrain have been allowing the establishment of wholly foreign-owned subsidiaries in most sectors of the economy for a long time. Oman is also in the process of opening up most sectors to wholly foreign-owned subsidiaries, while such possibility remains largely theoretical in Kuwait.

<sup>19</sup> In other words, a company registered in the jurisdiction whose equity is fully owned by one or more nationals of said jurisdiction.

<sup>20</sup> Between a foreign company and its local partner who may be active or silent, as the case may be.

<sup>21</sup> This may lead to separate tax treatments for each joint venture member, depending on its nature. For example in Qatar, a Qatari-owned company will not pay any income tax, the foreign partner in an incorporated joint venture will pay a 10% income on the share of profits it will receive from the joint venture company (not necessarily 49%, usually more if the foreign partner is the active partner whilst the local partner is dormant) and a branch will pay a 10% income tax on 100% of the profits generated locally.

Whilst a 50/50 joint venture is possible, it is usual for one member to have a larger share than the other member(s)<sup>22</sup>. Such majority partner will be designated as the leader of the joint venture; they will propose a project director who will be entitled to represent the joint venture vis-à-vis the employer and third parties and for the overall coordination of the project. However, the powers of the project director will usually be strictly controlled by a steering committee composed of a representative of each member and their role will be to implement the directives of such steering committee.

The number of representatives for each member as well as the quorum and decision rules (simple majority, qualified majority, unanimity) will be aligned on the participation shares. As with the shareholders' agreement, it is possible to agree on some reserved matters that the leader may not make without the minority partner(s). In general, unanimity and qualified majority decision making are a feature of contractual joint ventures, which may be required to agree on deadlock provisions in case of any difficulty in finding a common course of action.

These provisions on governance are essential because they will also dictate if and how profits can be consolidated. A specific accounting norm, IFRS 11, establishes principles for financial reporting and consolidation by entities that have an interest in "joint arrangements" such as an UJV or a consortium agreement<sup>23</sup>.

After the definition of the participation shares and of the governance of the joint venture, financial provisions will be equally essential. Members will want to define principles for their respective contributions in respect of working capital and funding policy, bonds and guarantees, profit sharing, costs, risks and liability sharing<sup>24</sup>, insurance and bank accounts<sup>25</sup>.

Bank accounts are an interesting feature of a contractual joint venture.

Given the contractual joint venture is not a separate legal body, it will not have its own assets<sup>26</sup>. However, by exception, the bank account(s) of the joint venture will be the only asset that the joint venture members will have in common.

According to regional practice, banks will typically accept, and actually often request, to open bank accounts in the name of the joint venture, provided each member has a proper registration, complies with the bank's client-vetting procedures and the rules of operation of the accounts are clearly specified. It means that the bank accounts of a joint venture can be targeted not only by the employer but also by creditors of each member, as we will further detail below.

Other essential clauses of a contractual joint venture are the liability and indemnification clauses. Employers in the GCC will invariably request members of a contractual joint venture to be jointly and severally liable towards them<sup>27</sup>. Joint venture members will therefore agree, as a matter of contract, to allocate liability between them and usually will agree on principles whereby the party whose fault has triggered the liability of the joint venture towards the employer<sup>28</sup> will ultimately be liable for its own fault<sup>29</sup>.

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<sup>22</sup> For example, a 55/45 or 60/40 repartition is usual for a two-party joint venture. When there are three members, a 40/30/30 or a 50/30/20 split are usually seen, although all kinds of repartition are possible depending on the parties at stake and on the nature of the project.

<sup>23</sup> Deloitte, Practical Guide to Implementing IFRS 11 (Joint Arrangements).

<sup>24</sup> In a joint venture situation, the sharing of profits, risks and liabilities associated with a single scope of work will be allocated between the parties on the basis of their participation shares. In a consortium situation, each party will derive profits and bear the risks associated with his own portion of the scope of work. This applies between the members as we will see that employers require joint and several liability of all members towards them.

<sup>25</sup> Which can be of several types: collecting accounts, operating accounts, escrow accounts

<sup>26</sup> For example, equipment will be imported and owned by each relevant member; employees will be employed and sponsored by each relevant member, although they might be seconded to the project.

<sup>27</sup> This will apply whether the joint venture is an UJV or a consortium, although on paper, it would seem more logical for each consortium member to be only liable for its own scope towards the employer given there is no single scope of work unlike in a joint venture situation. It should be noted that Sub-Clause 1.14 of the FIDIC Yellow Book sets a principle of joint and several liability of the Contractor towards the Employer when the Contract is a Joint Venture which is defined as "a joint venture, association, consortium or other unincorporated groupings of two or more persons, whether in the form of a partnership or otherwise". Such joint liability may be imposed by the law and not just by the contract, as is the case in KSA under the Government Tenders and Procurement Law (GTPL) which refers to a "solidarity agreement" to define a contractual joint venture, as further elaborated below.

<sup>28</sup> Liability of the joint venture towards third parties will be discussed in the next section.

<sup>29</sup> Certain provisions may also be added in case there is a dispute on who is liable for a fault and how to deal with this difficulty.

In a consortium agreement, an emphasis will be put on the definition of the scope of work of each member and on interfacing obligations between them, usually through a responsibility matrix, so that all members cooperate efficiently to deliver the final product expected by their client.

Finally, a UJV or consortium agreement will include standard clauses, usually called boilerplate clauses, which are seen in any commercial agreement, but which should nonetheless be properly drafted depending on the circumstances at stake<sup>30</sup>.

### ***Sophisticated structures and clauses that can be encountered***

As with any contract, the degree of sophistication of contractual joint venture agreements can vary to a significant extent: from 10 pages to 60 pages or more, annexes aside.

First of all, it is not uncommon, in larger projects, to encounter a superposition of various forms of contractual joint ventures: for example, a UJV between several contractors may enter into a consortium agreement with a rolling stock supplier, as was the case for one of the lines of the Riyadh metro.

To further complicate things, it can happen that a joint venture might be “hidden”. Usually, joint venture arrangements will be official: at bidding stage, several companies will declare an interest to the employer and bid together. If chosen, they will sign a joint venture or consortium agreement between them that will be known to the employer. With the employer and third parties, the joint venture will typically communicate through a letterhead showing the name and logo of each member and mentioning their alliance, sometimes under a specific name<sup>31</sup>.

However, it may happen in certain circumstances that an undisclosed joint venture may play a role in the project: for example, it can happen that a company appears as a subcontractor in a project (because it could not qualify as a main contractor or because it was too late to join the bid) but the members of the joint venture of main contractors may secretly agree to treat the subcontractor as another shadow member of the joint venture.

This distinction between a hidden and an official joint venture is acknowledged under Qatar law. As a matter of fact, whilst the Commercial Companies Law 11/2015 mainly deals with forms of incorporated companies, it does contain a few articles<sup>32</sup> dealing with the unincorporated joint venture<sup>33</sup>. These articles give large freedom to the parties to organize their contractual arrangement; they clarify that in case the joint venture is hidden, then a contract entered into by a member of the hidden joint venture will only bind such member, to the exclusion of the others.

However, when the joint venture is official, then the members of the joint venture may become jointly and severally liable for a contract signed by one of its members only. Typically, the joint venture agreement should describe in detail how the joint venture can make a commitment and what powers are vested with the project director who will be acting in the name of the joint venture<sup>34</sup>. However, should a representative of a member, being unauthorized to bind the joint venture, use the joint venture letterhead to enter into a contract with a third party, then all members of the joint venture may become jointly and severally liable<sup>35</sup>.

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<sup>30</sup> Effectiveness and duration; confidentiality, exclusivity and non-competition; IP rights; events of default; unwinding of the joint venture upon project completion; compliance with laws; force majeure; applicable law and settlement of disputes and other miscellaneous clauses.

<sup>31</sup> For example, the FAST Consortium on the Riyadh Metro; or the RLS (Red Line South) JV on the Doha Metro.

<sup>32</sup> Articles 53 to 61, Law 11 /2015

<sup>33</sup> Which is called “*joint venture company*”, which is slightly misleading given this is not an incorporated company. It is however quite similar to a concept of unregistered company known as “*société en participation*” or “*société de fait*” under French law.

<sup>34</sup> Proper powers of attorney will need to be prepared between the legal representative of each member of the joint venture and the project director so that he can be officially vested with the powers to bind the joint venture, which in effect means binding each and every member of the joint venture.

<sup>35</sup> Such liability with third parties would typically be unlimited. This can be of particular concern in case a member of the joint venture is a branch of a foreign company. As a branch does not have its own legal personality, it means a foreign company may not only be liable for the liabilities of its foreign branch but also of those triggered by other joint venture members.

Other clauses may be agreed upon to deal with a potential enlargement of the joint venture (during the bid or post award) or the reduction of a joint venture or the replacement of a member by another company, subject of course to the prior approval of the employer.

We are aware of situations where the replacement of a member was considered in the course of a project because such member faced an insolvency situation. Events of default clauses should deal with such a situation and allow other members to pursue the project alone or with another party. As evoked earlier, one area of risk is the joint venture bank account, which can potentially be targeted by creditors (including subcontractors or employees) of an insolvent member; this can be a strong incentive to eject a defaulting company.

### ***Freedom of contract vs mandatory provisions of local law***

As already mentioned, the key feature of a joint venture arrangement is its flexibility: there is a great deal of freedom left to the parties to organize their temporary association for the purpose of delivering a project.

This flexibility includes the possibility for the parties to agree on the law governing their contractual arrangement. Two options will usually be considered: either the joint venture agreement will be subject to the law where the project is to be delivered in order to be aligned with the law applicable to the main contract<sup>36</sup>; or the parties may agree on a neutral law (for example, Swiss law or English law).

Even when the agreement is governed by a foreign law, consideration should nonetheless be given to certain mandatory provisions of local law which might have an impact on the validity of the agreement.

These include:

- Foreign Investment Law: checking that each member of the joint venture or consortium agreement has a proper vehicle to be able to deliver its scope of work or services;
- Contract law: checking any specific requirement under local law, including the rules in terms of powers of attorney being given by each member to a project director and if such mandate shall be signed under a particular form;
- Public procurement law: in certain countries, prescriptions on contractual joint venture may be found in laws and regulations governing the procurement of public projects<sup>37</sup>;
- Corporate law: checking under which conditions a de facto company may be formed and if this could have any consequences<sup>38</sup>; checking if there are any provisions in terms of joint and several liability of the members towards third parties;
- Competition law: in the case of a joint venture, several competitors team up to deliver a project which can cause some competition law issues; this is rarely the case in the GCC where the respective markets are very fragmented and there is a high degree of competitive bidding but this may nonetheless need to be considered;
- Tax law: making sure the joint venture arrangement is transparent and no specific obligation applies in addition to those applying to each member<sup>39</sup>.

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<sup>36</sup> In the GCC, the main contract will always be governed by the law of the employer which is also the law where the project will be delivered.

<sup>37</sup> For example, in KSA, the GTPL deals with contractual joint ventures in its Implementing Regulations. Article 31 of these Implementing Regulations provides that bidders should execute their contractual arrangement (referred to as a "solidarity agreement") prior to submitting their bid and have it authenticated before the Chamber of Commerce or any equivalent authority. Article 31 also contains several paragraphs dealing with the expected content of such a solidarity agreement.

<sup>38</sup> Parties to a contractual joint venture are not supposed to have any *affectio societatis*; their cooperation is meant to be temporary, for the purpose of a specific project. This is usually reinforced by a clause in the joint venture contract clarifying that the intention of the parties is not to set up a separate legal body. However, notwithstanding the terms of the contract, it may happen that parties are behaving in practice similarly to shareholders of an incorporated company which can trigger a debate under local law as to whether a company has actually been formed and what consequences this can have in terms of the liabilities of the members/shareholders.

<sup>39</sup> For example, in the UAE, the Federal Tax Authority appears to request a contractual joint venture to have its own VAT registration in addition to that of each member. Customs may request the same.

As a conclusion, while joint venture and consortium agreements might seem relatively easy contracts to deal with, they may be more sophisticated than they seem. In particular, in case of larger projects, a detailed review of certain clauses can be useful; a client may find out that certain specific clauses can be developed on the basis of best practices that do not necessarily exist in the template they might be regularly using.

In any event, a review of conformity with the laws of the place where the project needs to be delivered is advisable in order to make sure the arrangement is built on solid foundations and does not infringe on any local legal or practical requirement.



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