

COMMENT ON THE ORGANIZATION OF MINERAL PROCESSING JOINT VENTURES — TOLLING COMPANIES AND OTHER CORPORATE VEHICLES

By W.M. Blanshard*

Let me commend Mr Armstrong on his paper and his comprehensive treatment of tolling companies. As this is the first time that the subject of mineral processing has been dealt with at an annual conference I shall preface my commentary with a few observations which may be relevant to the organization of such a project.

First of all, there has been political pressure for increased processing of minerals in Australia. There have been several enquiries including those by a Commonwealth/State Joint Study Group, by a joint Australia/Japan Study Group and by the Senate Standing Committee on National Resources.¹ Secondly, location will be determined not so much by the unchangeable presence of mineral deposits but by the availability and cost of power and water supplies, accessibility of transport and port facilities, the need for skilled labour for construction, operation and maintenance and the availability of government incentives. Distance from the sources of raw material supply will of course be a factor but not necessarily a major one. Raw materials means both those which are to be processed plus those which are needed in the processing operation itself. Thirdly, some of those determinants of location may lead to the establishment of the project closer to an existing centre of population or agriculture than would usually be the case with a mining project and hence environmental factors may assume increased importance. Fourthly, ownership of land might play a more important role certainly than in an exploration venture and probably than in a mining venture. Ownership of a buffer zone as well as ownership of the plant site itself may be necessary.

DISTINCTION BETWEEN TYPES OF VEHICLES

Throughout his paper, Armstrong mentions differences between incorporated and unincorporated structures. His first emphasis is on the joint venture which undertakes the establishment and operation of production facilities at which the raw material owned by the participants in the joint venture will be processed exclusively for their use or disposal. That is to say, the product will not be sold by the joint venture to the participants or to third parties, but rather the raw material will be processed on behalf of the participants. In emphasising this point he is readily able to distinguish between the "tolling" approach and the conventional company approach. In the latter case the company undertakes the various activities itself with an arms length sales of the processed products to the shareholders and/or third parties and, one might add, arms length purchases of the raw material. However in dealing with the tolling approach Armstrong is less able to draw a clear distinction between the advantages and disadvantages of using an incorporated vehicle (such as his tolling company) on the one hand and an unincorporated vehicle on the other. He acknowledges this difficulty and I shall return to this point during the course of my commentary.

There are references to the processed product being an intermediate or final one. Taking the case of the aluminium industry there are examples of a company participating in two joint ventures comprising different parties, one which produces an intermediate product, namely alumina, which will be processed into a more or less final product, namely primary aluminium by a second joint venture established to construct and operate a smelter. It may be that a different type of vehicle will be used at each stage in the processing chain. It is possible to add to the list of projects referred to in the paper by mentioning the Tomago smelter and the now abandoned Lochinvar smelter both in the New South Wales Hunter Valley and the Worsley Alumina Refinery in Western Australia, all being examples of unincorporated joint ventures.

Armstrong lists several reasons for retaining maximum flexibility and these are equally applicable to both an unincorporated or incorporated structure. To this list might be added a further reason for flexibility, namely the wish of some participants to receive a different type of product to the others. For example, again from the aluminium industry, to take molten metal rather than a cast product or to take different types of cast products.

STRUCTURE

The paper outlined a tolling company structure. Although one can discern a preference for an incorporated structure in the paper, the documentation requirements suggest in my view that the unincorporated approach is less complex. By way of illustration if the unincorporated approach were adopted the contents of the Memorandum and Articles of the tolling company, the Participants Agreement, the Tolling Agreement and the Expansion Agreement could all be encompassed in one joint venture agreement. Furthermore there are constraints in reconciling the statutory provisions of the company's legislation with the desired contractual arrangements of the parties if an incorporated vehicle is used. One such difficulty deals with the rights of parties on distribution of capital or profits on or before liquidation. This is one example of the Participants' Agreement seeking to prevail over the provisions of the legislation.

Regarding the participants' or shareholders' agreement it has become established practice to include in it as much of the arrangements between the parties as possible so that such arrangements are not on public record as is the case with the Memo and Articles. I have sometimes wondered whether S. 146 of the *Companies Act*, which is to be re-enacted in S. 251 of the new legislation, might in some circumstances oblige the parties to lodge a copy of the agreement with the Corporate Affairs Commission. The relevant parts of the section are

A printed copy of ... each resolution or agreement which binds a class of share holders, whether or not agreed to by all the members of that class; and ... each document or resolution that attaches rights to shares (whether or not in substitution for other rights) and is not otherwise required to be lodged with the Commission under this Act shall ... within one month after the passing or making thereof, be lodged by the company with the Commission.

Does this section mean that the Commission or an individual shareholder could insist on a participants' or shareholders' agreement being lodged and so becoming available for public inspection? In at least one case I have seen the Articles of an incorporated joint venture company make reference to the existence of a shareholders' agreement although it is more common not to draw attention to it in this manner.

Another point of comparison between incorporated and unincorporated structures is the right of pre-emption on assignment. As I understand it the rule of perpetuities does not apply to pre-emptive rights contained in Articles whereas this would not be the case with a joint venture agreement.²

Dealing with raw materials supply contracts Armstrong points out that these are not, as such, part of the consortium agreements, it being a separate and independent matter that the participants obtain their own supplies of basic raw material. He states that where more than one participant is a producer of the basic raw material there could be technical and economic considerations which favour the supply being from one source. These problems might be resolved by swap arrangements so that in order to ensure a uniform standard of raw material one producer may agree to swap his raw material for that of another supplier so that all feed stock for the plant will come from the same source.

PARTICULAR ISSUES

Accounting

In dealing with accounting questions the paper points to one of the essential differences between an incorporated and an unincorporated joint venture: The manner in which a participant incorporates its interests in its accounts. If, as in the case of a tolling company, the facility is erected by the company on land owned by that company, the ownership is clearly in the tolling company itself and not in the participants.

Tax

The ownership which I have described has certain tax consequences in that the tolling charges paid by the participants will cover deductions allowable to the tolling company for depreciation and investment allowance. This would result in a book profit in the tolling company in respect of the investment allowance, though not in respect of depreciation. By including depreciation and investment allowance in the tolling charge a positive cash flow in the tolling company results though I understand from Armstrong that this is eliminated by invoicing the full amount of the tolling charge to the participants but deferring indefinitely collection of the amounts referable to depreciation and investment allowance. Furthermore, I understand that the incorporated tolling company approach does not preclude the choice of depreciation method by each participant and that this is reflected in different rates of tolling charge.

So far as claiming the investment allowance is concerned, it is clear that the tolling company's services are provided by the company in its own right as it owns the plant and employs the staff to operate it. In the case of an unincorporated vehicle it would be usual to have a managing company but for investment allowance, depreciation and other purposes it is important to make it clear that such managing company acts as agent for the participants.

In some projects the separate ownership of certain items of plant by some only of the participants may be required; for example in the case of an aluminium smelter, additional cast house equipment for casting products required by one participant only. This requirement can readily be met by an unincorporated structure which is featured by separate ownership interests. In the case of a tolling company on the other hand, it would presumably be necessary for there to be a

separate agreement by the tolling company with that participant for the provision of staff for operating that item of plant but worded in such a way as not to derogate from the required use of that plant by the individual participant for investment allowance purposes.

On the subject of tax it may be worth amplifying some points made earlier. First, if buffer zone land is owned for environmental or other reasons and it is proposed that grazing or agricultural activities take place or continue on this land, it may be worthwhile to form a separate land holding company to own such land though not the plant site itself so that land tax exemptions for primary production enjoyed in some States might be utilized. Secondly, payroll tax rebates are available in some States for eligible manufacturing and processing industries situated in country areas and these may be worth studying to see if the particular processing business will qualify.

Management and Control

Under the heading of Management and Control the paper refers to the desirability of the managing company acting under the supervision, control and directions of the board of the tolling company although the extent to which the directors of the managing company can abdicate their responsibilities is arguable. There are also problems which can arise on the binding nature of contracts entered into by the managing company on behalf of the tolling company or, in the case of an unincorporated joint venture, on behalf of various participants. Various devices have been adopted to resolve this kind of problem which arises on dealing with third parties. The unreported decision of Sheppard J in the case of *Nabalco Pty. Limited v. B.P. Australia Limited*³ dealt with the role of a managing company in this type of case. The case went on appeal to the Privy Council but the question of the managing company's role did not become relevant in the appeal.

Consequences of Default

In this section of the paper the question of problems under default provisions and their possible treatment as penalties is reviewed. The question of penalties in the joint venture context may possibly come on for judicial review shortly. Litigation in the New South Wales Supreme Court was recently commenced arising out of default provisions in an oil exploration joint venture (but this case was settled). It appears from recent press reports that similar claims in other joint ventures are pending.

FOREIGN TAKEOVERS ACT

The attention focused on local processing recently led to a new section called "Resource Processing" being set up within the Real Estate and Resources Branch of the Foreign Investment Division of the Treasury. This section now covers matters previously dealt with by the Manufacturing Industries Section.

The sensitive questions of power supply and power pricing are primarily dealt with by other divisions of the Treasury and are factors to be considered as major processing projects are substantial consumers of power.

Armstrong concentrates on certain problems under the *Foreign Takeovers Act* itself but it should be borne in mind that the so-called guidelines are likely to be of comparable importance in a new processing venture or in the expansion of an

existing one. Although the Australian Standard Industrial Classification is used by the Treasury for determining whether a new business has been established, a new project will be examinable even though the company involved already has other projects in the same industry. Examples could be given from both the aluminium and the coal industries.

Armstrong comments on provisions in the agreements which could result in changes in interests in the project, for example, the assignment clause or the default clause. It is true that the FIRB reserves the right to re-examine the position if the assignment or default provisions are invoked. Furthermore although interests in shares arising under a money lending agreement are technically disregarded under the Foreign Takeovers Act, nevertheless foreign lenders are invited to talk to the FIRB with a view to Australian equity levels being restored following exercise of rights under lending agreements.

Although there was speculation beforehand that the guideline requiring at least fifty per cent Australian ownership and control in mining projects would be extended to processing projects, the Treasurer's pronouncement on 20 January 1982 did not extend the fifty/fifty requirement although encouragement was given to as high a degree of Australian equity as is possible in processing projects. As a practical matter the Treasury seeks to achieve a fifty per cent Australian content.

TRADE PRACTICES CONSIDERATIONS

It is relevant to make the point that the range of participants in a tolling venture is limited to companies which are or want to be competitors. Even an institutional investor which becomes a participant must secure its own source of raw material supply and participates in the sense of becoming a competitor even though its role as a competitor is obscured by obtaining its raw material from another participant or industry supplier and by selling through others.

It would not be possible to have a tolling approach except in the above manner. A tolling company makes no profit and therefore there is no return in it for an investor except as a pure lender.

The tolling company or venture keeps control of the products in the hands of its participants and does not introduce a new competitor in the shape of the conventional company which sells its products in its own right and on an arms-length basis.

Projects of this nature are a way in which Australian companies obtain an introduction to new technology and experience as there is invariably a "lead" participant already experienced in the industry and owning or having access to technology.

Although there are restrictions as described in the paper it does not necessarily follow that authorization is required.

FOOTNOTES

* LLB (Syd) Solicitor, Sydney

- 1 (a) Commonwealth/State Joint Study Group on Raw Materials Processing, Discussion papers 1 and 2, 1981.
(b) Senate Standing Committee on National Resources, Report on the Development of the Bauxite, Alumina and Aluminium Industries, 1981.
(c) Treasury Economic Papers Numbers 5 and 8 being submissions to the Senate Standing Committee.
2. See Halsbury, 3rd Edn. Vol. 29, 306 para. 612.
3. Unreported decision of the Supreme Court of N.S.W. on 8th July, 1976, 831, 832.