

**Disputes
in
Joint Venture / Shareholders' Agreement**

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Lalit Kumar, Partner

J. Sagar Associates
advocates & solicitors

- Call and Put Options
- Reserved /Veto Matters
- Concept of “Control” with respect to Reserved Matters
- SEBI v. Subhkam Ventures (I) Private Limited
- Transferability of Shares and Valuation thereof
- Non-compete / Non-Solicitation
- Representations and Warranties
- Indemnity
- Liquidation Preference

Call and Put Options

- Both Call and Put Options are enforceable
- **Put Options from FEMA Perspective:**
 - No assured exit
 - 1 year lock-in
 - Exit as per the price prevailing at the time of exit
- **Call and Put Options from SEBI's Perspective:**
 - the title and ownership of the underlying securities should be held continuously by the selling party for a minimum period of one year from the date of entering into the contract
 - the price or consideration payable for the sale or purchase of the underlying securities pursuant to exercise of any option contained therein, is in compliance with all the laws for the time being in force as applicable
 - the contract is settled by way of actual delivery of the underlying securities:

Reserved / Veto Matters

- No specific provisions regarding reserved matters in any legislation
- Different legislations construe it differently
- No complete clarity under Companies Act, 2013, FDI Policy, SEBI Regulations, Insurance Act about treatment of reserved matters
- CCI in the recent case of Caladium Investment/ Bandhan Financial held that the reserved matters including (i) change in the auditors of the company and (ii) amendment to MOA/AOA will amount to negative control
- Are provided at both the board and the shareholders' level
- Quorum of party required when reserved matters are taken up
- Are they enforceable?
- Do they result in control?
- Can be better protected now by providing an entrenchment provision in the articles of association

Concept of “Control” with respect to Reserved Matters

- Subjective and inclusive definition of control to include *de-facto* and *de-jure* control. Defines “control” as follows:

“control” includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner:

Provided that a director or officer of a target company shall not be considered to be in control over such target company, merely by virtue of holding such position

- Control has two distinct and separate features, namely:
 - The right to appoint majority of directors (***factual part***)
 - The ability to control the management or policy decisions (***subjective part***)

Concept of “Control” with respect to Reserved Matters

➤ The right to control can accrue in any of the following manner:

➤ Through Shareholding

➤ Through Management Rights

➤ Through Investment / Shareholders’ Agreement

➤ Voting Agreements

➤ In other manner

➤ Regulation 4 (Acquisition of Control) of Takeover Code provides:

Irrespective of acquisition or holding of shares or voting rights in a target company, no acquirer shall acquire, directly or indirectly, control over such target company unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations

SEBI v. Subhkam Ventures (I) Private Limited

- The point of law that was being disputed: whether the rights such as the right to nominate a director on the board of the company, the right to be present to constitute quorum and the affirmative voting rights all of which is essentially “**negative control rights**” constituted “**control**” for the purposes of the takeover code
- SEBI’s position: the definition of “**control**” would include veto rights since such negative control would effectively control the management and policy decisions of a company
- Differing from the SEBI’s position, Securities Appellate Tribunal (SAT) in its order dated January 15, 2010 held: “**control**” meant **positive control**, that is, the ability to cause a company to perform certain actions, and that it did not cover rights constituting “**negative control**”, i.e. the right to prevent the company from doing certain actions. The SEBI had appealed the aforesaid decision of SAT before the Supreme Court.
- Both SEBI and Subhkam Ventures reached an out of court settlement in the matter and the Supreme Court passed an order disposing off the appeal. The Supreme Court’s order dated November 16, 2011 accepting the out of court settlement between SEBI and the respondents, specifically states that the question of law (i.e., whether negative control is control) remains open and that the SAT decision would not be treated as precedent. This observation has far reaching ramifications

Transferability of Shares

- Right of First Offer / Right of First Refusal / Lock in / Tag Along / Drag Along / Call Option / Put Option
- Now enforceable both in a private limited company and a public limited company
- Concept of “absolute discretion of the board” provided in the articles of association of a private limited company
- Section 58(2) of the Companies Act, 2013 provides that a contract with respect to transferability of shares will be enforceable as a contract even in the case of a public company
- Has to be ensured that provisions of transferability are provided in the articles of association of the company to make them binding on the company and the shareholders– Supreme Court ruling in Rangraj’s case

Non-compete / Non-Solicitation

- Usual to insert a non-compete but enforcement specific or otherwise a big question mark – though Indian law different from usual common law rule of “reasonable restriction” acceptability
- Section 27 of Contract Act renders “void” a non-compete restrictions except in case of “sale of a business” with goodwill and that too with specific limitations on duration, scope and geographic extent
- Selling Shareholders cannot be prevented from undertaking employment in a competing business
- Confidentiality obligations are enforceable
- Non-solicitation is enforceable

Representations and Warranties

- Representation - statement of fact that relate to a state of affairs that exists in the present or existed in the past

The purpose of representation is to induce reliance, establish standard and to allocate risk. Remedy for misrepresentation would be avoidance and restitutionary recovery or damages

- Warranty - is a promise that a statement is true

The purpose of warranty is to provide indemnity if a statement is not true and to allocate risk. Remedy for breach of warranty would be damages

- Who represents and warrants – company or promoter or both?
- Whether absolute or qualified – best knowledge qualifiers
- Limitation : different levels – e.g., tax liabilities 7 or more years

Indemnity

- Indemnity - Indemnities are often considered in the context of liability to reimburse a contracting party from liabilities asserted by third parties (non-contracting parties)
 - Generally all possible triggering events are provided including a party's own negligence is a triggering event
 - Pre-conditions to indemnity rights (notice of potential claim, restriction on settlement without consent of indemnifier, monetary limits etc.).
 - Enforceability of liquidated damages - In India liquidated damages becomes a cap - penal damages will not be enforced
 - Threshold for invoking indemnity claims-individual and aggregate thresholds
 - Cap on indemnity liability
 - Use of escrow by acquirer to recover indemnity claims

Liquidation Preference

- Permitted under the Companies Act in the event of winding up
- Can be contractually agreed for both in the event of winding up and also when the sale of shares / companies takes place (such as Trade Sale)
- In the event of winding up it is best enforced when the instruments held are preferred instruments, for example, preference shares / debentures
- In case of equity shares it is more of a contractual right than a legal right
- Generally preference is provided to the extent of amount invested by the investor

Thank You

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