Joint Venture Agreements

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What is a JV?

A joint venture arrangement is normally something more than a co-investing arrangement. "**A joint venture involves an investment, but every investment does not result in a joint venture**". E.g., a private equity investor is a 'financial investor", with focus on a return on investment. In contrast, a joint venture brings parties together for 'strategic' reasons coupled with a financial investment.

The journey of a joint venture starts with identifying the purpose of the JVC which could be

- **Resource Sharing**: Respective capabilities may be combined to generate synergies of business.
- **Technical Know-how**: A party may need to have technical know-how but not the resources to implement and vice versa.
- **Accessing Markets**: A party may decide to leverage existing distribution channels/ marketing of another party.

Joint Ventures / JV Agreement / Shareholders Agreements

A JVA/ SHA sets out

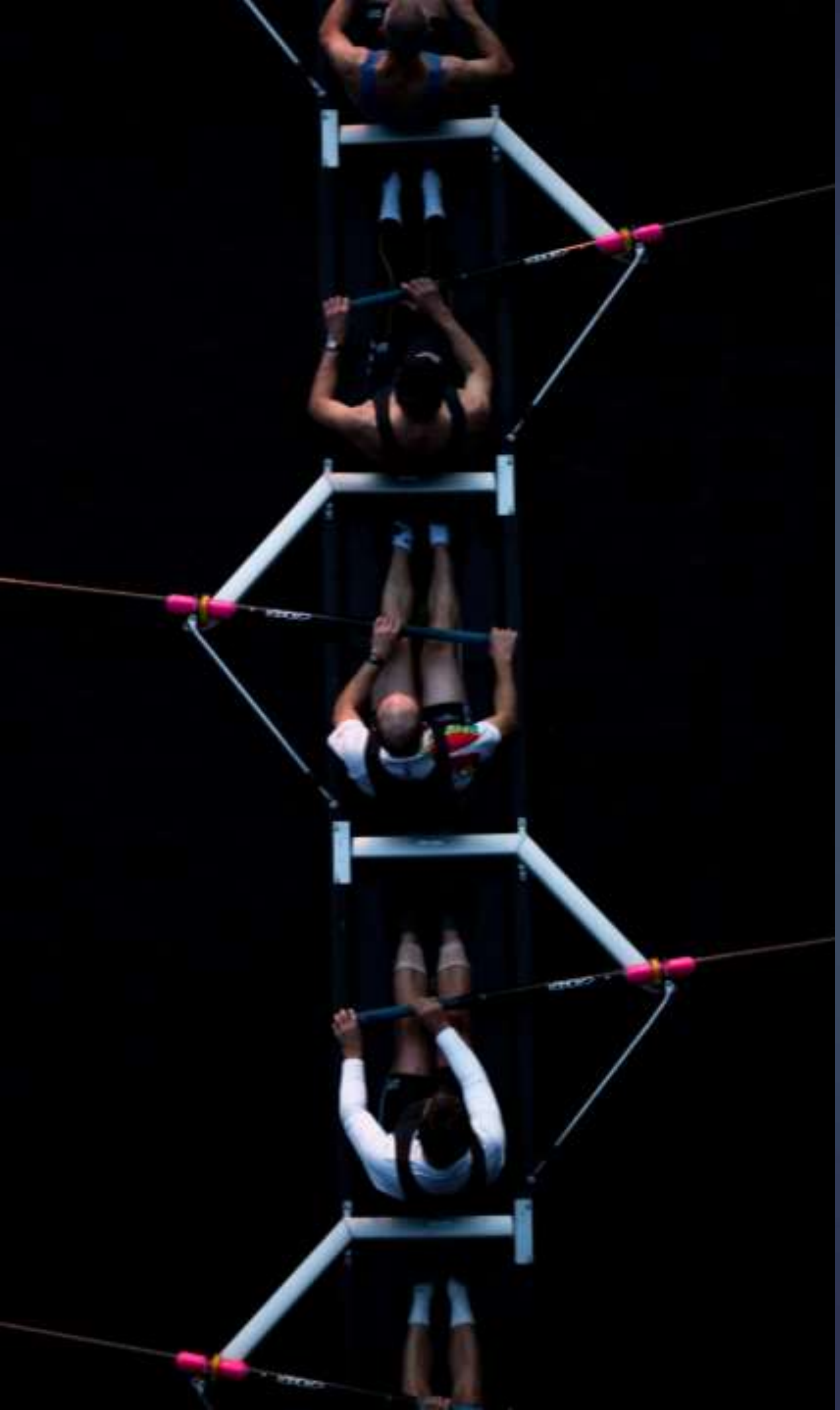
- the respective capital contributions and the shareholding of the parties entering into the joint venture agreement/shareholders’ agreement
- the overall governance structure
- day to day management of the JVC
- provisions in relation to non-compete between the parties (including the exclusivity provisions or the first right of the JVC to participate in additional opportunities for the agreed business)
- provisions for exit of one or more of the shareholders
- identifying and preparing ancillary agreements which will incorporate arrangements between the JVC with one or more of the parties/ group entities, e.g., in relation to brand, technology, services, distribution, business transfer
- miscellaneous provisions such as representations and warranties, applicable law, dispute resolution mechanism, breach consequences, termination rights and the like

Joint Ventures / JV Agreement / Shareholders Agreements

A very important distinguishing feature of a JVA is that termination of the JVA/SHA may end the agreement, but cannot, by such termination, affect the shareholding of the shareholders nor impair the statutory rights attached with such shareholding. The JVA's/SHA's contractual rights are replaced by shareholders' rights under law.

As an example, a minority shareholder with 10% shareholding continues to exercise the right to institute an oppression–mismanagement action even if the JVA/SHA is terminated. A minority holding more than 25% can block special resolutions. As a result, post termination obligations like non-compete, exclusivity in dealing, etc., should not be linked to continued shareholding as often occurs but should be linked to termination of the JV.

<u>Non-compete/Exclusivity</u>: Exclusivity provisions in favour of the JV company (for the same or similar business) are often critical and carefully thought-out provisions in the JVA/SHA depending on the circumstances. As an example, if the JVA/SHA is terminated for breach of a party these should be continuing obligations for such a breaching party so that it cannot take the benefit of its own wrong and start a competing business while enjoying the benefits of the JV as a continuing shareholder.



Minority Protection and Issues

A JVA/SHA generally, provides contractual rights for parties over and above what is available under law, particularly for the minority. As an example, a minority joint venture partner with even a 49% shareholding will need board representation under the JVA/SHA and protection against the removal of the directors by the majority shareholder, which is otherwise permitted under law.

Note: *Shareholders do not owe a fiduciary duty to each other while directors owe a fiduciary duty to all shareholders.*

As an example, among other protections, minority shareholders need protection from unanticipated dilution in future fund raises from shareholders, such as a rights issue, which only requires an ordinary resolution. That gives the basis for preemptive rights on fresh issues, as capital is often the lifeblood of the business and most disputes result from a failure or unwillingness to fund by one shareholder or the other. At the same time what has been agreed by the parties to fund should become an obligation. For that reason, an agreed business plan with a capital commitment plan is agreed upon and becomes binding amongst the shareholders and a failure to fund gives rise to a breach and a falling away of the anti-dilution protection.

Minority Protection and Issues

The general view is that rights over and above what are available under law can be conferred to a minority shareholder but **rights available under law to a minority shareholder cannot be taken away**. E.g., special veto rights over items which can otherwise be passed by majority shareholders can be given to minority shareholders, however, the right of a 10% shareholder to approach the tribunal for oppression-mismanagement cannot be taken away.

At the same time the JVA/SHA can also be the balancing document where parties agree to "give or reduce" rights available under law. As an example, the agreement may create an obligation for the minority to vote with the majority or support certain decisions where its contrary vote could stall the decision by the JVC

The viability of increased thresholds in the AoA and JVA/SHA which benefit the minority including for special and ordinary resolution items vs. the thresholds provided in the Companies Act need to be considered in light of Section 6 of the Act which specifies that the Act shall prevail notwithstanding anything contrary in the charter documents, any agreements entered by the company, any board or shareholders resolutions, etc.

Affirmative Rights – Substantial vs. Protective: Possible Implications

Definition under Companies Act, 2013 -

"control" shall include 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.

***Implication**: persons in control may deemed to be promoters which has increased accountability amongst other issues under the Companies Act.*

Definition under Takeover Code -

"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:

SEBI order in United Spirits (2018)- "if the test of control was to be satisfied, the veto rights must have been sufficient enough to govern the decision making process of a company's management or policy decision……"

***Implication**: in the case of a listed company, acquisition of control even when shareholding/ voting rights are less than 25% can trigger an open offer .*

Definition under Competition Act-

"control" includes controlling the affairs or management.

***Implication**: acquisition of 'control' can lead to notification requirements.*

Definition for Exchange Control (FEMA) –

"control" shall mean the right to appoint majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreement or voting agreement and for the purpose of LLP, "control" shall mean the right to appoint majority of the designated partners, where such designated partners, with specific exclusion to others, have control over all the policies of an LLP;

***Implication**: an Indian company can be treated as "foreign controlled" which brings in limitations in its conduct in matters such as further downstream acquisitions, pricing, sectoral caps, etc.*

Articles of Association – Transfer Restrictions on Shares Held by JV Partners

Basic principle based on precedent: Share transfer provisions need not be in the articles to be enforceable as long as the company is a party to the agreement and the articles are not contrary to the agreement.

For public companies, the Companies Act, 2013, by definition implies that its shares should be freely transferrable. However, Section 58(2) of the Act clarifies that "*securities of any member in a public company shall be freely transferable* <u>*provided that any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract*</u>".

In case of listed companies, the LODR Regulations provide for parity in voting rights over shares already listed.

The 50:50 JV

On the face of it, a 50:50 JV is completely irreconcilable. In our experience, 50:50 JVs are the best examples of out of court settlements since leverage of parties is balanced and equally limited.

Attempts at a deadlock resolution mechanism are often "a Client's Nightmare and a Lawyer's Dream" owing to uncertainly as to whether what was planned as a fair option for the parties at the time of preparing the JVA/SHA will play out when it has to be exercised.

As an example, a party whose brands/ products/ technology/ distribution benefits and drives the business at the time the option is exercised vs. when the JVA/SHA was made (which benefits will continue if it takes over the venture but end if the other takes it over) would be able to value the shares at a higher price than the other. As a result, deadlock resolution will mean a forced exit for the other party.

Exiting a JV

Put/Call options: Put option is a right but not an obligation to sell shares to the other party. Call option is a right but not an obligation to buy shares from the other party.

These are generally used by financial or minority investors to obtain an exit.

Call options are also used for strategic foreign shareholders to have the right to increase their shareholding when regulatory changes permit etc. over time. E.g., telecom, insurance and other sectors where FDI limits have increased over time.

Position of Nominee Director

Nominee directors of shareholders often face a challenge in balancing their "loyalty" to the appointing shareholder and discharging their fiduciary duties as directors to all shareholders and being mindful of the duties laid down in section 166 of the Companies Act, which include:

- acting in accordance with the AoA
- promoting the objects of the company for the benefit of the members and in the best interest of other stakeholders
- exercising his/her duties with reasonable care and diligence and exercise independent judgment
- not getting involved in situations which may conflict with the interests of the company
- not seeking any undue gain or advantage