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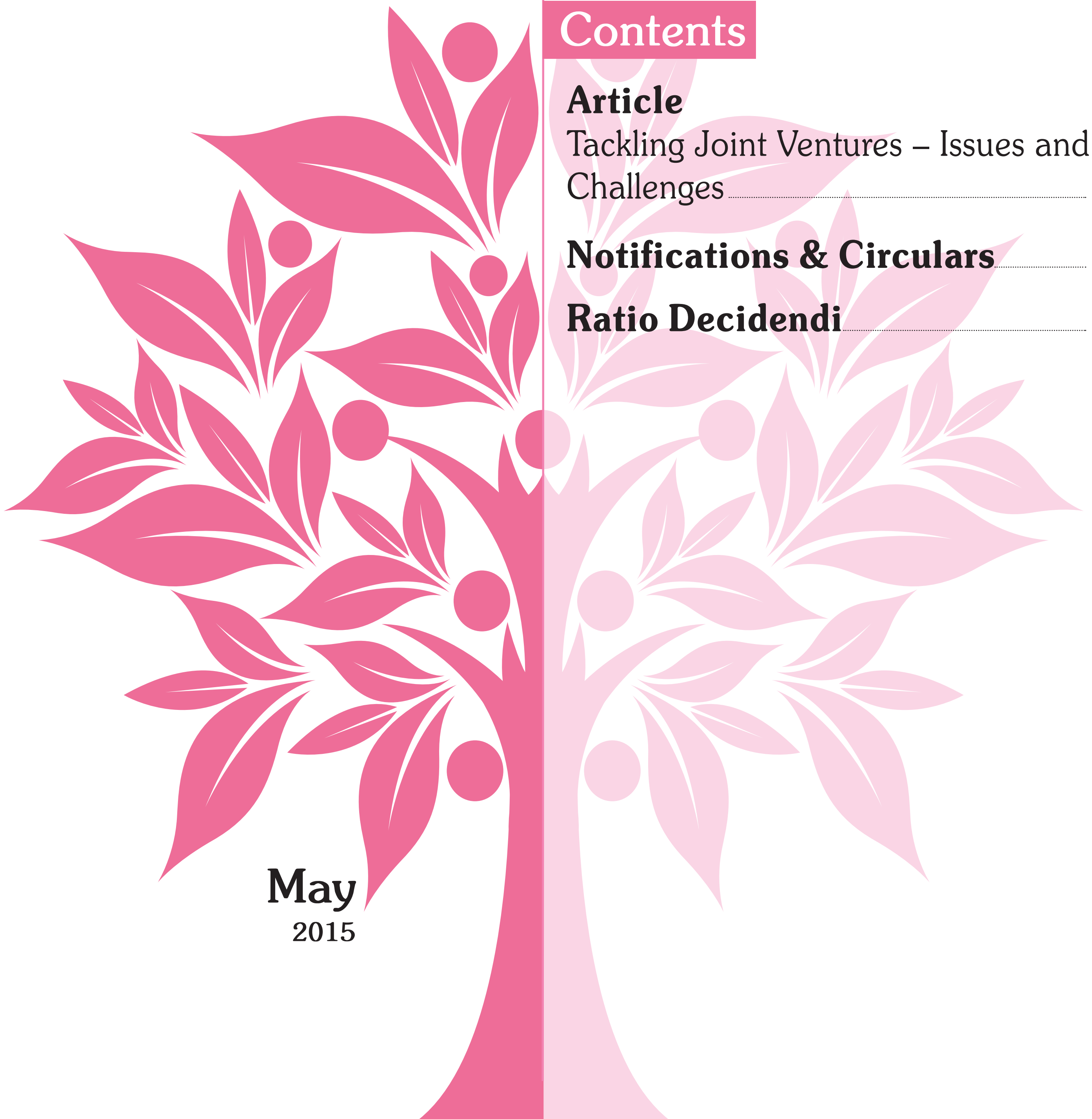

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Article

Tackling Joint Ventures – Issues and Challenges

By **Ronak Ajmera**

The business rationale for a joint venture (JV) ranges from pure play financing of business operations to longer strategic partnerships for sharing of technical/business knowhow. To a large extent, the issues which need to be resolved between potential JV partners depend on the deal commercials and nature of the proposed JV and the partners themselves. However, regardless of the nature of the JV, potential partners must strive to have these issues adequately addressed in the JV documentation so as to ensure that they are prepared, in case the partnership turns sour. This article discusses certain legal issues which potential JV partners must tackle at the stage of finalizing the transaction structure and documentation.

Minority Protection Rights

Decision making rights of shareholders in companies are usually proportionate to the equity shareholding they hold. Therefore, it is important for a minority JV partner to secure an adequate say in the company's affairs so as to avoid being mistreated by the majority. Such protection is usually obtained by way of affirmative voting rights i.e. matters which require a positive/affirmative vote of the minority partner for it to be approved. Typically, such matters would *inter alia* include approval of the business plan and annual budget, anti-dilution protection and raising of debt by the JV. While this has been the trend so far, we may witness a paradigm shift on account of the recently enacted Companies Act, 2013. As such rights may result in the minority partner being reclassified as a 'promoter' of the JV, thereby exposing it to various unintended liabilities, parties may consider other alternatives to secure such protective rights.

Deadlock Resolution

Parties are usually optimistic about the JV's prospects as well as their equation with the JV partner at the inception stage. As a result, given the sensitivity around discussing a prospective deadlock between partners, it may be challenging to discuss the deadlock resolution mechanism during negotiations. All the same, it is imperative to record the understanding between parties on the way forward in case of a deadlock in decision making. While mutual discussions/mediation may, of course, be the first step towards resolution, if parties are unable to reach an agreement, the deadlock must lead to one party buying out the other. Various innovative methods may be built in to facilitate a fair valuation at such exit. JV partners should consider dealing with this aspect upfront at the time of negotiations rather than postponing the same to a more advanced stage in the life of a JV.

Dispute Resolution

The JV documentation would typically provide for a mechanism by which disputes between JV partners would be resolved. For

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instance, parties may agree that if their senior management fails to resolve a dispute through mutual discussions, the same would be resolved by arbitration. While this may seem to be a relatively quicker mechanism vis-à-vis traditional litigation, arbitration may prove to be a costly affair. It is possible that the attitude of corporates towards litigation, as a dispute resolution method, would change once the commercial divisions of High Courts (as proposed) are established. These commercial divisions are intended to achieve speedy finality to disputes and would also award legal costs to the successful litigant. If these objectives are achieved, litigation would be an option worth considering. However, if parties are considering arbitration as a dispute resolution mechanism, they may consider institutional arbitration i.e. arbitration conducted by specialised bodies such as the Indian Council of Arbitration (ICA), Singapore International Arbitration Centre (SIAC) or the London Court for International Arbitration (LCIA), which has recently set up a body in India. As opposed to *ad hoc* arbitration, which could result in delays in appointment of arbitrators, conduct of proceedings, etc., institutional arbitration is governed by the rules framed by the concerned institution. This would facilitate a timely and systematic conclusion of arbitration proceedings.

Exit Methods

Financial partners have a clear objective of exiting their investment within a pre-defined time period (usually 4-7 years) with a certain return. If such investment is received from non-residents, it must be either in the form of equity shares or instruments which compulsorily convert into equity shares, in order to qualify as FDI. All other instruments are regarded as debt and are governed by a more restrictive regime applicable to external commercial borrowings. Non-resident investors are not permitted to receive an exit at a price higher than the fair value of such instruments. Further, in accordance with Indian exchange control regulations, they cannot receive an assured return on their investment either. This makes structuring of an offshore inbound investment a bit more difficult as compared to a pure domestic investment. Financial investors would usually want to exit the JV after its listing. However, an IPO may not always prove to be a feasible option at the given time on account of market conditions. Therefore, a financial investor would insist on alternatives to be built into the documentation which facilitate a suitable exit for its investment. In such cases, parties must negotiate their respective rights carefully so that they do not end up on the receiving end of a sour deal.

In addition to the above, JVs may encounter other legal and regulatory challenges in terms of director's liability, where the minority has nominated representatives to the board of the JV. Under the Companies Act, 2013, fiduciary duties of directors have been codified, breach of which is punishable. Further directors having knowledge of contraventions (through receipt of proceedings of the board) would be classified as officers-in-default and accordingly, would be liable for such contraventions by the company.

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Given the uniqueness of the dynamics involved in each JV, there is no uniform solution which can be applied while dealing with such issues. A lot depends on the nature and risk appetite of the parties involved. Financial partners tend to be more cautious and are advised to mitigate liabilities. Strategic players, on the other hand, usually have a long term approach towards such investments and are less risk averse.

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Notifications & Circulars

Companies Incorporation Rules amended: Ministry of Corporate Affairs has amended the Companies (Incorporation) Rules, 2014 with effect from 1-5-2015. According to the amendments, Rule 5 of the basic rules, providing for penalty on One Person Company or any officer of such company in case of any contravention of the said rules, has been omitted and new Rule 7A which provides for similar provisions but with reduced quantum of penalty, has been brought into force. Further, in respect of particulars to be filed with the Registrar at the time of incorporation (Rule 16), requirement of verification of specimen signature and latest photograph by the banker or notary, has been dispensed with. Now the promoter or the first Director has to self attest the same in Form No. INC. 10. Rule 36 has also been inserted to provide for new integrated process for incorporation. This new optional process for allotment of DIN, reservation of name, incorporation of company and appointment of Directors by way of one Form No. INC-29, is available from 1-5-2015.

SEBI notifies formats for disclosure under new Insider Trading Regulations: SEBI has notified four disclosure forms for the purpose of various disclosures under Rules 6 and 7 of the SEBI (Prohibition of Insider Trading) Regulations, 2015. SEBI Circular CIR/ISD/01/2015, dated 11-5-2015 states that such disclosures can be maintained by the company in physical or electronic mode. This circular also directs the companies to formulate code of practices and procedures for fair disclosure of unpublished price sensitive information and the code of conduct, and confirm same to the stock exchanges immediately. Companies are also now required to deal with only such market intermediary or person handling the sensitive information, who had formulated the code of conduct according to the regulations. Stock exchanges have also been directed to put in place adequate systems and make necessary amendments in the relevant bye-laws.

Export of goods or software – RBI dispenses with Statutory Declaration Form (SDF): Reserve Bank of India has dispensed with the requirement of declaring export of goods or software in the SDF in case of exports taking place through EDI ports. RBI A.P. (DIR Series) Circular No.101, dated 14-5-2015 states that mandatory statutory requirements contained in the SDF have now

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been subsumed in the Shipping Bill format. It may be noted that Shipping Bill (Electronic Declaration) Regulations, 2011 have also been amended by the Ministry of Finance and CBEC has issued Circular No. 15/2015-Cus., dated 18-5-2015 in this regard.

Power generation in SEZ – Guidelines revised: Ministry of Commerce has withdrawn power generation guidelines issued by Notification No. P.6/3/2006-SEZ dated 21-3-2012, with effect from 1-4-2015 while restoring earlier guidelines issued by Notification No. P.6/3/2006-SEZ.1, dated 27-2-2009. According to SEZ Circular dated 6-4-2015, henceforth, developers/co-developers are entitled to setup power plant only in non-processing area of the SEZ and operation and maintenance benefit shall not be available to such power plant. Further, existing power plants are also to be demarcated as non-processing areas.

FDI – Ministry of Commerce issues consolidated FDI Policy: Department of Industrial Policy & Promotion in the Ministry of Commerce has issued consolidated Foreign Direct Investment (FDI) Policy effective from 12-5-2015 (Circular No. 1 of 2015). It may be noted that the present document does not make any change in the FDI Policy as such in respect of various sectors, and is an exercise of consolidation of all the changes made by the government during the last one year. 51% equity or FDI cap in the multi-brand retail trading sector has been retained.

Ratio Decidendi

Creation of National Company Law Appellate Tribunal constitutionally valid – Supreme Court directs amendments in Companies Act, 2013

Five Judge Bench of the Supreme Court of India has rejected the challenge to the constitutional validity of setting up of the National Company Law Appellate Tribunal (NCLAT). The Court in this regard rejected the contention of the petitioner that the earlier 2010 judgment of the Court dealing with the issue of constitutional validity of the National Company Law Tribunal (NCLT) and the NCLAT (under Companies Act, 1956) did not discuss the issue relating to NCLAT and hence same should not be treated as binding in respect of the Appellate Tribunal. It was noted that the discussion in the earlier judgment included NCLAT and hence it was not open to the petitioner to argue this issue as it clearly operate as *res judicata*. Reliance on another judgment of the Apex Court relating to National Tax Tribunal (NTT) (wherein the Court had held the same as unconstitutional), was also rejected by Court pointing out the differences between NTT and NCLAT.

However, in respect of appointment of Technical Members, both in NCLT and NCLAT, the Court placed reliance on the earlier judgment and struck down Sections 409(3)(a) and (c) and 411(3) of the Companies Act, 2013. It was held that for appointment of Technical Members to the NCLT, directions contained in sub-para (ii), (iii), (iv), (v) of para 120 of the earlier 2010 judgment will have to be followed

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and corrections made in Section 409(3) of the new provisions. The Court in this regard noted that provisions (in the Companies Act, 1956) relating to appointment of Joint Secretary with certain experience, as Member Technical in the NCLT, were specifically struck down by the Court in 2010 but, same provisions have now again been made part of Section 409(3) of the Companies Act, 2013.

Similarly, provisions of Section 412(2) of the new Companies Act, relating to Selection Committee for appointment of President/ Chairperson and Members, were found to be not valid and direction was issued to remove the defect by bringing the provision in accord with sub-para (viii) of para 120 of 2010 judgment. [*Madras Bar Association* v. *Union of India* - Writ Petition (C) No. 1072 of 2013, decided on 14-5-2015, Supreme Court]

Arbitration – Relief against third party

Relying on earlier judgments, the Delhi High Court has held that while considering a petition under Section 9 of the Arbitration and Conciliation Act, the Court is within its right to pass order against third party. It was also held that when jurisdiction of the Court is invoked post-award by way of petition under Section 9, interim protection can be granted. Respondent's argument that some of them were not parties before the Arbitral Tribunal and that they were independent entities under the Companies Act, and hence petition under Section 9 would not be maintainable, was rejected by the Court.

The Court however observed that it should restrain itself from passing an order which has the effect of implementing the award because such order would frustrate the challenge to the award under Section 34. It was held that the order should be such which would secure the interest of the party having the award in its favour so as to seek effective implementation if the challenge to the award is rejected. [*VLS Finance Ltd.* v. *BMS IT Institute Private Limited* - O.M.P.(I) 114/2015 & IA No. 7506/2015, decided on 5-5-2015, Delhi High Court]

Sale of shares of Indian company by foreign company, outside India – Jurisdiction of Company Law Board

Madras High Court has set aside the Company Law Board's order which had held that in a case involving sale of shares of the Indian company by the foreign company, on action by one of the secured creditors of the latter, the question as to whether the Receiver outside India made best efforts to get maximum relief to the creditors of the foreign company, and the question whether there was proper advertisement before sale of the shares, were not issues that would come within the jurisdiction of the Company Law Board in India to adjudicate. The Board in its impugned order had though held that it had jurisdiction to entertain a dispute regarding such sale in the United Kingdom, of the shares of the Indian company held by the foreign company, it ruled that it had no jurisdiction to test the fairness of the procedure adopted by the Joint Receivers in England.

Relying upon definition of 'share' in Sections 2(46) of the Companies Act, 1956 and after noting provisions as in Sections 36(1), 108(1)

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and 111, the Court was of the view that the extent to which the foreign company was entitled to transact upon the said property (shares of the Indian company) is always subject to the Indian Laws and that any transfer can take place only in accordance with the procedure prescribed in the Companies Act, 1956. It was observed that challenge in this case was not the procedure as adopted by foreign Insolvency Court, but it was an attack on the Director of the Indian company who had taken the shares for a token consideration. [*N.R. Harikumar* v. *WW Apparels (India) Private Limited* - Company Appeal No.3 of 2011, decided on 16-4-2015, Madras High Court]

'Exclusive agreements' by e-commerce sites with sellers of goods/services, not anti-competitive

Considering various factors listed in Section 19(3) of the Competition Act, the Competition Commission of India (CCI) has held that 'exclusive agreements' by e-commerce portals with sellers of goods/services, to sell specified goods exclusively on those portals, does not lead to 'Appreciable Adverse Effect on Competition' (AAEC). It was hence held that said vertical agreements cannot be said to be anti-competitive under Section 3(4) of the Act. The Commission in holding so noted that while such arrangements did not create any entry barrier for new entrants and no existing players in the retail market were getting adversely affected, such online distribution channels of the parties (respondents) provided an opportunity to the consumers to compare the prices as well as the pros and cons of the product. The informant in this case had contended that due to such arrangements, the consumer was left with no choice in regards to terms of purchase and price of the goods and services.

While rejecting the plea of dominance, the Commission agreed with the view of the e-commerce portals that every product cannot be taken as a relevant market in itself. The informant in this context had contended that each of the opposing parties had 100% market share for the product in which it was exclusively dealing and therefore the same would lead to dominance. The Commission however held that irrespective of whether e-portal market was considered as a separate relevant product market or a sub-segment of the market for distribution, the parties were not dominant. [*Mohit Manglani* v. *Flipkart India Private Limited* - Case No. 80 of 2014, decided on 23-4-2015, CCI]

Arbitration – Order of Arbitral Tribunal need not be detailed

Delhi High Court has held that merely because the award given by the Arbitral Tribunal did not contain its deliberations in great detail, it cannot *per se* be held that there was no application of mind by the said Tribunal. The Court in this regard stated that format of an award has not been prescribed and that the Tribunal is not expected to deliver an award like a judgment of a court. Further, noting that the Tribunal comprised of Technical Members, the High Court was of the view that to expect Technical Members to deliver an award in the form of a judgment would be contrary to the very principles of arbitration,

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and such Members are not expected to explain in detail the basis of formation of their opinion. While setting aside the Single Judge Order, it held that the Arbitral Tribunal is the master of facts and is entitled to even commit errors of fact. [*Rakesh Kumar and Company* v. *Union of India* - FAO(OS) 273/2014, decided on15-4-2015, Delhi High Court]

Jurisdiction of Competition Commission in respect of agreements entered into prior to 2009

The Competition Commission of India has held that fact of execution of an agreement prior to 20-5-2009 would not immunize conduct of the party altogether from the scrutiny of the Competition Act, 2002. Contention of the opposing parties that since the concept of 'imposition', 'abuse' or 'dominance' was not present at the time of signing of the agreements, said agreements were perfectly valid and non-abusive, was rejected by the Commission. The CCI in this regard also placed its reliance on the order dated 19-5-2014 passed by COMPAT observing that the order had categorically confirmed Commission's jurisdiction. The opposing parties had also relied upon the said order to contend that Commission had no jurisdiction to look into such agreements. [*Pankaj Aggarwal* v. *DLF Gurgaon Home Developers Private Limited* - Case No. 13 & 21 of 2010 and Case No. 55 of 2012, decided on 12-5-2015]

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