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‘Estate planning’ needed as joint ventures may go awry

When a joint venture (JV) is set up between an Indian and an overseas company, both parties usually have a bullish view of things to come and an eagerness to get started with the business.

Despite the best intentions however a JV’s business plans often come unstuck for reasons such as: a basic mismatch in ideologies or temperaments of the partners; a modification in market conditions or dynamics that make the business unviable; a change in law that could make the business difficult; business losses or poor viability of the project.

When faced with the decision to wind up a JV, the partners may be ill prepared both psychologically and legally. Many a time they turn resentful and hostile, with one or both parties unwilling to cooperate with the other in the winding-up process. Financial defaults may also occur due to one or both partners’ unwillingness to settle the accounts in an attempt to take advantage of the situation.

Certain steps, described below, can be considered and used in a manner akin to buying insurance or doing estate planning at the inception and initial investment stage of the JV.

The shareholders’ agreement (SHA) is crucial. It should be drafted carefully and all parties should ensure that each shareholder signs it. If new shareholders come in at a later date, they should sign a deed of adherence and become bound by the SHA.

A good SHA should contain clear guidelines on divestment of shares by a single party or group of shareholders. The powers of the shareholders and of the board of directors should be clearly defined. Clear guidelines on how the JV can be brought to a close and limitations on obligations to invest further in the JV should be defined. Intellectual property rights (IPR) and use of a partner’s name along with a process by which the use of IPR and name can be terminated should be agreed.

Since parties may refuse to cooperate after a dispute, automatic processes without the need for a “no objection certificate” are usually useful. The non-compete clause as well as the requirement for a no objection certificate for another business for each JV partner should be drafted with utmost caution.

All JV partners should ensure that their representatives are well represented on the board of directors and are signatories of bank accounts. If the JV closes, non-represented parties will get the worst deals during the liquidation process.

An Indian business must usually register with the Registrar of Companies of the Ministry of Corporate Affairs, and the Tax Department, and is subject to Reserve Bank of India (RBI) reporting requirements, registration under various labour acts, registration of trademarks, patents or copyrights, and other registrations depending on the industry or the state where the business is domiciled

All JV parties should ensure that they are aware of all such registrations and that there is no default or an ongoing obligation to comply even after the liquidation or termination process has been concluded.

On closure of the JV: (a) the statutory dues of workers and employees must be cleared; (b) all tax payments must be cleared; (c) bank accounts must be settled and closed wherever possible; and (d) all tax and other registrations must be surrendered. Substantial liabilities are possible if the termination process is concluded or the divestment of one JV party is complete but the closure process has not been completed in a specific area.

Over the years each JV party invests substantial capital and sometimes debt in a JV involving a foreign party. Under Indian law and RBI guidelines all capital and debt deployed has to be reported in a return every month to the RBI through an authorized dealer bank, along with a specific loan number for debt. In the case of a compliance lapse, it becomes a Herculean task to take the capital or debt back. If the parties are in a dispute, this task becomes a nearly impossible.

Any registration made under the JV company’s name requires a clear “no objection letter” from the JV partners as well as the JV company. These aspects should be covered by an IPR agreement or in the SHA.

The Insolvency and Bankruptcy Code, 2016, provides the JV parties in a non-functional company with a new opportunity to bring the business to a hassle-free closure.

In conclusion, being pragmatic and legally well advised at the inception of a joint venture can help build a stable foundation that can withstand any sort of a shock that comes during the course of business.

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