NAVIGATING RIGHTS IN JOINT VENTURE AGREEMENTS: THE IMPACT OF INSOLVENCY ON STAKEHOLDER PROTECTIONS

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"An agreement is only as good as the paper it's written on, until it's tested by adversity."

— Samuel Goldwyn

1. Introduction

Joint ventures (incorporated, unincorporated and strategic alliances) have been the preferred business arrangement for most technologically driven infrastructure sub-sectors like electric vehicles, charging infrastructure, hydrogen, manufacturing of solar modules and wind turbine generators and some other technologically critical sectors. The utility and the symbiotic nature of joint venture arrangements has also been observed as valuable for industrial sectors which contain several technical aspects, such as oil and gas, chemicals, electronics, and atomic industries.[95] The Supreme Court of India has qualified joint venture structures as a collaborative business arrangement undertaken for mutual profit, characterized by the contribution of assets and the sharing of risks[96]. Foreign companies owning technology leverage the experience of established Indian conglomerates in the sectors to enter the Indian market. Joint ventures prove to be an effective model, allowing both joint venture partners the flexibility in terms of the roles and contributions of each party, the tenure of the arrangement, and the means of sharing the assets and liabilities.

The past decade has caused upheaval in businesses with the advent of a pandemic, geopolitical tensions and the shift in global powers. Given that the joint ventures are usually adopted in strategic scenarios, which may also stem from fulfilling the requirements of the government tenders which provide for change of control restrictions, exit from a joint venture, may at times, become tricky. In such scenarios, joint ventures, especially the cross-border ones, must brace themselves for unprecedented events including insolvency of partners involved and misalignments between joint venture partners. This article explores the pinch points which may arise during the term of the incorporated joint venture and the exit options available to joint venture partners in such events.

2. Protection against default of the JV Partner(s)

[92] Senior Partner, AZB & Partners
[93] Partner, AZB & Partners
[94] Senior Associate, AZB & Partners
[95] New Horizons Ltd. v. Union of India (1995) 1 SCC 478
[96] *Ibid.*

Consequences of default under joint venture agreements, typically, vary depending on the nature of the default. Defaults resulting in termination of the joint venture agreement, in case of an incorporated joint venture, usually triggers the exit rights of the joint venture partners, including call options, allowing non-defaulting joint venture partner to buy the stake of the defaulting partner at a defaulting shareholder's stake (possibly at a discount), put options, allowing the non-defaulting joint venture partner to sell its stake to the defaulting partner or its affiliate at a premium, or less commonly, winding-up of the joint venture company. In cases where the joint venture is an unincorporated one, the exits may also be in a similar nature of requiring the defaulting or insolvent joint venture partner to either buy out the stakes of the non-defaulting joint venture partner in the unincorporated joint venture or transfer its stakes to the non-defaulting joint venture partner.

While joint venture agreements may include watertight provisions regarding default triggers and exit rights of the non-defaulting joint venture partner(s), the implementation of such exit rights, especially in case of insolvency of the defaulting joint venture partner(s) can become complex.

3. <u>Issue venture partner: of pricing vis-à-vis a foreign joint</u>

As per Rule 5 of the Foreign Exchange Management (Non-Debt) Rules, 2019 ("**NDI Rules**"), "*A person resident outside India holding equity instruments of an Indian company containing an optionality clause in accordance with these rules and exercising the option or right may exit without any assured return, subject to the pricing guidelines prescribed in these rules and a minimum lock-in period of one year or minimum lock-in period as prescribed in these rules, whichever is higher.*" The intent of including the aforementioned provision in the foreign exchange regime in India is to prohibit foreign investors investing in India from seeking assured returns from their investments. Foreign investors selling their shareholding to residents are only entitled to fair market value of the securities as determined by an internationally recognized pricing methodology and duly attested by a chartered accountant, a Securities and Exchange Board of India registered merchant banker or a practicing cost accountant. Similarly, foreign investors can only purchase the shareholding of a company from a resident at a minimum purchase price equal to the fair market value of the relevant securities as determined above. Therefore, a put option entitling a foreign joint venture partner to sell its stake to the resident joint venture partner at a premium or a call option entitling the foreign joint venture partner to buy the resident joint venture partner's stake at a discount will be considered in breach of the NDI Rules and the foreign exchange regulations prevalent in India.

However, the aforementioned rule is not one without exceptions. The courts in India have, in many instances, enforced a call option or put option giving assured returns to the non-resident investor/joint venture partners where such rights have been exercised as exit rights of the relevant

non-resident investor/joint venture partners on account of default of the other shareholders/joint venture partners.

In the case of *Cruz City 1 Mauritius Holdings v. Unitech Ltd.*[97], the Delhi High Court settled the question of whether exercise of put options or call options could be considered as transactions resulting in 'assured returns' of the foreign joint venture partner, in contravention of the applicable foreign exchange laws in India. The Delhi High Court held that as put options and call options are exercisable in the event of breach of contractual assurances (in this case being the delay in commencement of the project) provided to the foreign investor, the assured rate of return resulting from enforcement of such right was enforceable and not violative of the extant foreign exchange regulations.

In the case of *Percept Finserve Private Limited v. Edelweiss Financial Services Limited*[98], the Bombay High Court upheld the enforcement of put option by Edelweiss against Perceptive Finserve Private Limited ("**Perceptive Finserve**"), stating that the put option was not a forward contract but merely a right to resell the shares upon Percept Finserve's failure to fulfill its obligations under the share purchase agreement executed between Edelweiss and Percept Finserve.

While judicial precedents like the aforementioned ones allow foreign joint venture partners to enforce exit rights such as put options at a premium price and call options at a discount in case of default of joint venture partners, it is still advisable for foreign joint venture partners to structure their exit rights in line with the prevailing foreign exchange regime. To circumvent the financial loss the foreign joint venture partner may suffer on account of such structures, the transactions could be structured to provide for 2cross-defaults under other transaction documents involving the defaulting joint venture partners and the defaulting joint venture company or its parent company (in case of insolvency or cash crunch) may be required to pay compensation to the foreign joint venture partner at the time exercise of exit rights.

4. Pre-emptive Rights

Pre-emption rights, in essence, mandate a legal entity to give priority to its holder over others with respect to acquisition of stake of the other joint venture partners in the joint venture partner. Pre-emption rights are both statutorily held and contractually negotiated in India.

Statutory pre-emption rights in India include the right of each shareholder of a company under Section 62 of the Companies Act, 2013 to be offered equity shares in proportion to their shareholding in the company, for any capital calls made by the company. Upon refusal by such

[97] 239 (2017) DLT 649

[98] 2023 SCC OnLine Bom 319

shareholders, the shares will be then offered to third parties. Statutory pre-emption rights of this nature offer anti-dilution protection to shareholders holding minority stake in the companies.

Contractual pre-emption rights included in joint venture agreements include right of first offer and right of first refusal, which provides the right holder to be offered the shares of the joint venture company proposed to be sold by the other shareholders to the right holder before being offered or sold to the relevant third party. Pre-emption rights are usually found in joint venture agreements and shareholders agreements to offer a safety net for the joint venture partners/shareholders by enabling them to be able to control and restrict the entry of new shareholders[99]. They act as double-edged swords both hindering and facilitating swift exits to joint venture partners.

5. Recognition of Pre-emption rights under Indian laws

The Expert Committee on Company Law, while analysing the erstwhile Companies Act, 1956, noted that recognition to pre-emptive rights and other contractual rights under joint venture agreements through corporate action is possible only if they are made part of the articles of association of a company. It also suggested inclusion of suitable provisions under the Companies Act, 2013 recognizing such arrangements between two or more substantial shareholders or joint venture partners. Based on this recommendation, Section 58(2)(a) was introduced under the Companies Act, 2013 (which repealed and replaced the erstwhile Companies Act, 1956) which states that, while the securities of a public limited company are mandated to be freely transferrable, contracts between shareholders of a public company in respect of transfer of securities are enforceable as a contract.

Therefore, since the enactment of the Companies Act, 2013, pre-emption rights of shareholders included in the articles of association are not only enforceable against the shareholders as contractual rights, but it is also enforceable against the company as a provision of the articles of association of the company.

6. Enforcement of remedies under joint venture agreement in case of insolvency of joint venture partner

Insolvency regimes across the world including the Insolvency and Bankruptcy Code, 2016 ("**IBC**") in India, consider maximization of value of the debtor as sacrosanct objective of insolvency resolution process. The courts in India have emphasized on revivor of the debtor and in application of the 'clean slate doctrine' on the resolution applicant who takes over the debtor's management and assets as part of the corporate insolvency resolution process ("**CIRP**") under IBC. However, a significant aspect of insolvency resolution, which is often in conflict with the

[99] 'Right of First Refusal (ROFR) in Shareholders' Agreements', *Agrud Partners,* 2024.

aforesaid principles of 'revival', 'value maximisation' and 'clean slate', is the treatment of executory contracts in insolvency i.e., contracts are essentially those in which performance (other than payment) remains outstanding at the time of filing of the petition for CIRP under IBC.

After admission of an insolvency petition for the debtor, the IBC permits the tribunals to declare a moratorium during which, (a) institution of suits or continuation of pending suits against the debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority is suspended; (b) the debtor is prohibited from transferring or disposing off any of its assets or legal rights; (c) foreclosure or recovery of security interests by creditors of the debtors is suspended; and (d) recovery of any property in possession of the debtor is not permitted. This brings the operation of the corporate debtor to a standstill and the corporate debtor is only permitted to continue operation of essential contracts for sustenance during the CIRP. This clearly puts joint venture partners in joint venture with corporate debtors in a significant disadvantage as the joint venture agreement falls within the ambit of the moratorium. In such a scenario, the solvent joint venture partner either has the option of terminating the joint venture agreement and enforcing its exit rights against the insolvent joint venture partner before imposition of moratorium or continuing the joint venture agreement and requiring the joint venture partner to honor its pre-emptive rights at the time of approval of CIRP.

In insolvency law parlance, contractual provisions allowing for termination of a contract by a party (terminating party) with a counterparty (debtor) on the occurrence or subsistence of events of default relating to application for insolvency, commencement of insolvency resolution proceedings, appointment of resolution professional and other insolvency-related events are referred as *ipso facto* clauses. Hence, termination provisions on account of insolvency of a joint venture partner will be considered as an *ipso facto* clause during CIRP of the insolvent joint venture partner. As the IBC is silent on treatment of *ipso facto* clause, there is no uniform code for treatment of such clauses during CIRP. However, guidance may be sought from their treatment by courts in specific cases.

The Supreme Court in the case of *Gujarat Urja Vikas Nigam Limited v. Mr. Amit Gupta & Others*[100], urged the legislature to set out concrete guidance regarding treatment of *ipso facto* clauses during CIRP. However, in this case, the Supreme Court prohibited termination of the power purchase agreement on account of CIRP of the corporate debtor stating that such termination would have resulted in the debtor not being able to continue as going concern, as this contract was central to its revival. A similar stance was taken by the Supreme Court in the case of *TATA Consultancy Services*

[100] 2021 (7) SCC 209

Limited v. Vishal Ghisulal Jain, Resolution Professional, SK Wheels Private Limited[101], where it reiterated that 'a party can be restrained from terminating the contract only if it is central to the success of the CIRP'. Hence, while the legality of *ipso facto* clauses under joint venture agreement remains moot on account of lack of legislative guidance, one can infer that the courts will be inclined to invalidate termination provisions under joint venture agreements after the commencement of moratorium, if the CIRP of the insolvent joint venture partner hinges on the subsistence of the joint venture.

The treatment of *ipso facto* clauses during CIRP highlights the importance of having robust termination rights under joint venture agreements on account of insolvency. The trigger for termination on account of insolvency of a joint venture partner should commence from the date of filing of the insolvency petition instead of the date of its admission by the relevant courts of law. The joint venture agreements should also facilitate enforcement of exit rights such as call options and put options against the parent company or affiliate or group company of the insolvent joint venture partner, if such joint venture partner fails to honor the exit rights of the solvent joint venture partner under the joint venture agreement.

Regulation 39(7) of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, governing execution of CIRP processes under IBC, prohibits initiation of any proceedings against the interim resolution professional or the resolution professional for any actions of the corporate debtor prior to the insolvency commencement date. Therefore, if the joint venture agreement does fall within the trap of moratorium imposed with respect to the insolvent joint partner, the treatment of the rights of the solvent joint venture partner under the joint venture agreement including pre-emptive rights and exit rights would depend entirely on the treatment of executory contracts in the resolution plan approved during the CIRP of the insolvent joint venture partner.

In the case of *Geopetrol International Inc. Vs. JEKPL Pvt. Ltd. & Anr.*[102], after a series of litigations, National Company Law Tribunal ("**NCLT**") constituted under IBC approved the resolution plan of Atyant Capital India Fund-1 for CIRP of JEKPL Private Limited ("**JEKPL**") by its order dated February 4, 2020 ("**NCLT Order**"). Subsequently, Geopetrol International Inc. ("**GPI**") challenged the NCLT Order before the National Company Law Appellate Tribunal ("**NCLAT**") claiming pre-emption rights on the Participating Interest ("**PI**") held by JEKPL in the Kharsang Field. GPI sought a recall of the corporate insolvency resolution process until a notice of pre-emption is issued in terms of the joint operating agreement executed by the parties for enabling

[101] Civil Appeal No. 3045 of 2020
[102] [2020] ibclaw.in 267 NCLAT

parties to the JOA to exercise their pre-emptive rights. GPI argued that the PI was a principal asset of the corporate debtor and any direct or indirect sale of the said participating interest to be strictly governed by the provisions of the Production Sharing Contract and the Joint Operating Agreement executed by GPI and JEKPL. However, the NCLAT dismissed GPI's appeal for enforcement of such pre-emptive rights stating that GPI was neither an operational creditor nor a financial creditor in the CIRP of JEKPL. Hence, GPI's claim for enforcement of the pre-emption rights under the Joint Operating Agreement does not qualify as a security interest or any other right as 'operational creditor' or 'financial creditor' and the appeal can be filed against approval of a plan by any aggrieved person o any ground, mentioned in sub-section (3) of Section 61[103] of the IBC.

Similarly, in the case of *Vedanta Limited vs. Athena Chhatisgarh Power Limited*[104], the NCLT, while approving the resolution plan of Vedanta Limited (resolution applicant), approved the provision of the resolution plan which requires suspension of the enforcement of any pre-emptive rights against the shares of the corporate debtor from the date of takeover of the corporate debtor by the resolution applicant. A similar provision of the resolution plan was approved by NCLT (Kolkata bench) in the case of Laseer Solar LLP vs. Kannan Tiruvengadam[105].

The aforementioned cases highlight that the courts, while dealing with CIRP of an insolvent joint venture partner, may not require the lenders to honor pre-emptive rights of the solvent joint venture partner under the joint venture agreement, before selling the corporate debtor as a going concern to the successful resolution applicant. In such a scenario, the joint venture partners are at a risk of continuing the joint venture with the resolution applicant as a successor to the insolvent joint venture partner.

Insolvency of the joint venture partner is not the only event that may affect the pre-emptive rights of the other joint venture partners with respect to incorporated joint ventures. There are scenarios where the insolvency of the parent company of the joint venture partner may also hinder exercise of pre-emptive rights by its holders under a joint venture agreement.

[103] 61 (3) An appeal against an order approving a resolution plan under section 31 may be filed on the following grounds, namely:— (i) the approved resolution plan is in contravention of the provisions of any law for the time being in force; (ii) there has been material irregularity in exercise of the powers by the resolution professional during the corporate insolvency resolution period; (iii) the debts owed to operational creditors of the corporate debtor have not been provided for in the resolution plan in the manner specified by the Board; (iv) the insolvency resolution process costs have not been provided for repayment in priority to all other debts; or (v) the resolution plan does not comply with any other criteria specified by the Board.

[104] IA No. 1440 of 2022 in CP No. 616/7/HDB/2018

[105] I.A.(IBC) 953/KB/2022 in CP (IB) 515/KB/2018

In the case of *Mr. Pravin R. Navandar, Resolution Professional of the VOVL Ltd. Vs. BPRL Ventures BV and Committee of Creditors of VOVL Ltd.*[106], BPRL Ventures BV ("**BPRL**") had entered into a joint venture with Videocon Energy Brazil Limited ("**VEBL**"), a step-down subsidiary of VOVL Ltd. ("**VOVL**"), and under the joint venture agreement executed by the parties, BPRL had a pre-emptive rights over the quotas held by VEBL in their incorporate joint venture, IBV. However, the lenders of the now insolvent VOVL Ltd. had created a pledge over the VEBL Quotas and resultantly, the VEBL Quotas was considered part of the security package that VOVL's lenders. Hence, even though VEBL itself was not insolvent at the time of the dispute, the lenders of VOVL proceeded with sale of the VEBL Quotas without honoring the pre-emptive rights of BPRL under the joint venture agreement between VEBL and BPRL. The NCLT upheld the exercise of pre-emptive rights by BPRL under the joint venture agreement before foreclosure of pledge and sale of the VEBL Quotas by VOVL's lenders.

The aforementioned judgment of NCLT showcases that even in cases of group insolvency, which is currently not explicitly governed by IBC, exercise of pre-emptive rights and exit rights by joint venture partners may be contested or hindered by lenders of group companies in whose favour such assets or shares are encumbered.

7. Conclusion

It remains undeniable that stakes in a joint venture company could be considered as a critical asset of an insolvent joint venture partner and may have a direct bearing on the ability of the debtor to remain viable enterprise. Thus, insolvency regimes like the IBC and the courts enforcing such insolvency regimes will continue to treat joint venture agreements with an aim to ensure the continuation of the insolvent joint venture partner as a going concern and its efficient resolution. It would be entirely on joint venture partners to, therefore, legislate the treatment of pre-emptive rights and exit rights in case of insolvency more carefully, after considering the risks of abeyance of the rights of the solvent joint venture partner after admission of the insolvency petition of the insolvent joint venture partner.

Given these scenarios, joint venture partners may not restrict their remedies under a joint venture agreement only to exit rights and pre-emptive rights in case of insolvency of the defaulting joint venture partners. The joint venture agreement may include comprehensive action plan including the obligations of transfer of licenses, leasing of property or transfer/license of technology used in the joint venture business to the solvent joint venture partner upon trigger of termination rights on account of insolvency under the joint venture agreement. This will ensure that the continuance

[106] I.A. No. 702 OF 2024 & I.A. NO. 2787 OF 2023 IN CP(IB) NO. 2742(MB)/2019

of the business of the incorporated joint venture by the solvent joint venture partner and hand over of the reigns of the business to the solvent joint venture partner.