

When Joint Ventures Go Wrong – 7 Steps To Consider

written by Rohan Chinnappa | March 24, 2022



Despite collaborative efforts and mutual understanding, it is possible for the parties interested in the joint venture to disagree and thereafter lead to joint venture termination. However, if things turn sour or in the event of a default, insolvency of one party and change in control of a joint venture party may call for a termination 'for cause' – subsequently, the interests of the non-defaulting party ought to be protected^[1].

Joint ventures are an avenue for businesses to synergize their finances, manpower, skills and resources for their collective business goals. In comparison to raising funds utilizing procuring loans, bank overdrafts or venture capital assistance; joint ventures with interested businesses can be considered cost-effective and comparatively less laborious alternatives.

Joint ventures allow businesses to ramp up the scale of their operations, access new markets and most importantly, new consumers. In India, businesses may collaborate to form a structured or contractual venture. Accordingly, a new corporate entity or a limited liability partnership may be set up.

It would be ideal for a non-defaulting party to strategize a crafty exit, protect its finances, consider tax implications, assets, its ongoing business and ensure the wages of the employees and statutory benefits are cleared.

Disputes may also arise over the goodwill established during the course of business, the intellectual property and confidential information of the venture. It is imperative to therefore be vigilant of the scheme of arrangements that the parties intend to bind each other by and to be aware of the mutual terms, arrangements, rights and liabilities.



Joint Venture Termination

Termination In A Structured Joint Venture – Key Considerations

A structured joint venture can be formed by the creation of a body corporate, i.e. either a company or a Limited Liability Partnership (LLP). In the event of a termination, the laws governing the dissolution of structured joint ventures are laws such as the Companies Act, 2013, the Limited Liability Partnership Act, 2008 and the Insolvency and Bankruptcy Code, 2016^[2]. For both companies and LLPs, irrespective of whether it is voluntary or through an order issued by the respective tribunals, a liquidator has to be appointed who shall have the responsibility to consider the assets and settle any pending dues and liabilities. Thereafter in order of priority, the remaining assets would be distributed among the shareholders.

Termination In A Contractual Joint Venture – Sacrosanctity Of The Joint Venture Agreement

A joint venture agreement, if not craftily drafted to tighten the exit mechanism, raises the possibility of termination if frequent reference is

made to the exit clauses, it is a sign of a strained relationship between the parties and if there are stringent clauses it may scare away a partner interested in entering into an agreement similar to how a detailed prenuptial agreement may scare away a potential spouse[3].

It is thus necessary to include clauses that (clearly and simply) lay down the rights of the parties, limit the liability of a non-defaulting party and a straightforward exit mechanism if the relationship turns sour. The extant law that governs the relationship between the parties entering into a contractual joint venture is the Indian Contract Act, 1872 and the Specific Relief Act, 1963. If a non-defaulting party, in the event of a breach or a default wishes to maintain the relationship, it may approach a court of law seeking specific performance so that the defaulting party fulfills its obligations.

7 Steps To Consider

In the instance there is no choice but to terminate the contractual joint venture, the following steps are to be carefully considered:

1. Change of Control – Any change in ownership of a business that is a party to a joint venture has substantial consequences on the counter-party. It is therefore important to prioritise in the clause if there is a necessity to either terminate the joint venture agreement or to renegotiate the terms of the agreement. The clause may also be drafted in a manner wherein permission from the counter-party is mandatory before the change in control of the business.
2. Financials – A termination may lead to a dispute between the parties involved in the joint venture as to the status of the financials of the company. Drafting a clause that would bind an exiting party if there is any financial assistance extended to it is a recommended step.
3. Assets – Another issue that may arise immediately after the termination of a joint venture is concerning the assets purchased during the joint venture. It is important to lay down the ratio for the distribution of assets. Assets in this regard may be tangible and intangible -- including intellectual property rights. If there is no express clause addressing this issue, the dispute may be resolved by asking the courts to intervene. Distribution by the courts may be done proportionately as per the capital contributed towards acquiring the asset.
4. Limitation of Liability – A clause in this regard is to be carefully considered and must be drafted in a manner wherein the liability of a party is limited by the contribution made towards the setting up of the firm.
5. Goodwill & Confidential Information – It is crucial to draft a clause wherein the control over the goodwill and the confidential information that is developed during the course of business is retained and may also supplement with additional protection made by an assignment in the case there is a change in control of the company.
6. Arbitration – Post-termination in the instance there are any disagreements or disputes, it is necessary to first try and resolve the issue through alternative dispute resolution mechanisms. The courts in India also suggest parties unclog their disputes alternatively so that the burden on the courts is reduced.
7. Non-Compete & Non-Solicitation – Although the general law in the Indian Contract Act is that the agreements which restrain trade are unlawful, however, in consideration of the unfair competition or monopolies that may

develop in light of a party utilizing the know-how obtained during the joint venture, as an exception, a negative or a restrictive covenant may be inserted to avoid such unfair practices.

Before entering into a contract and also at the time of termination of the joint venture agreement it is always necessary to conduct due diligence on the party with which a business enters into a joint venture. For both structural and contractual joint ventures, it is always necessary for a business to be aware of the scheme of the arrangement, documents shared, agreements entered into between the parties. Provided that a business is vigilant, unnecessary losses and the risk profile would be minimised upon termination

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- [1] Danny Lee and John Morrison, Terminating a joint venture and the consequences, LEXOLOGY, July 18, 2013, <https://www.lexology.com/library/detail.aspx?g=26ba7c1f-732e-4c31-a154-4288271cbfb9>
 - [2] Soumitra Banerjee, Anjali Haridas, Joint ventures in India: overview, THOMSON REUTERS PRACTICAL LAW, October 1, 2017, [https://uk.practicallaw.thomsonreuters.com/w-011-5363?transitionType=Default&contextData=\(sc.Default\)&firstPage=true#co_anchor_a617052](https://uk.practicallaw.thomsonreuters.com/w-011-5363?transitionType=Default&contextData=(sc.Default)&firstPage=true#co_anchor_a617052)
 - [3] Peng, Mike W., and Oded Shenkar. "Joint Venture Dissolution as Corporate Divorce." The Academy of Management Executive (1993-2005), vol. 16, no. 2, Academy of Management, 2002, pp. 92–105, <http://www.jstor.org/stable/4165845>. Contributed by Rohan Chinnappa, Associate