

# *Legal Updates*

*Vinod Kothari & Company*

## Law of Joint Ventures in India

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### **Introduction:**

The importance and relevance of business is in providing products or services to customers. These products or services in the present day world are provided by entrepreneurs who organize, manage and assume the risk of starting businesses mainly for earning profit. Business makes the best possible use of scarce resources such as men, machines and materials for the production of goods. One of such ways carrying out a business undertaking is by making a strategic alliance with one or more individuals or entities usually for a single business project, which is popularly known as Joint Venture. There are many advantages of forming a Joint Venture over the conventional form of carrying on business, like providing companies with the opportunity to gain new capacity and expertise, access to greater resources and capital particularly in terms of staff and technology, sharing of risks with the venture partners and the limited life span of joint ventures. However since money is involved in a joint venture, it is necessary to have a strategic plan in place. In short, both parties must be committed to focusing on the future of the partnership, rather than just the immediate returns. Ultimately, short term and long term successes are both important. In order to achieve this success, honesty, integrity, and communication within the joint venture are necessary.

### **What does this Article do?**

This article examines the legal nature of Joint Venture in the light of the various interpretations given by the judiciary, its meaning under the Indian Accounting Standards with special emphasis on the main contents of a joint venture agreement vis a vis the Shareholders' Agreement alongwith the various approvals to be obtained from the Government in respect of joint ventures and matters connected therewith or incidental thereto.

### **Meaning and Definition:**

A Joint Venture may be defined as a contractual agreement or a business relationship between two or more people for the purpose of executing a particular business undertaking. All parties agree to share in the profits and losses of the enterprise.

From legal and organizational standpoint, joint ventures can be of two different forms i.e. equity joint ventures and contractual joint ventures. In equity joint ventures, two or more partners participate to create a new corporate entity wherein each one of them owns a given share of the equity capital. However such a thing is absent in contractual joint ventures wherein the only internal legal relations between the

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parties as well those the parties, on one hand, and third parties on the other are structured and regulated on a contractual basis.

Equity type joint ventures may include passive financial investments by portfolio investors. There are again inter-firm co-operative agreements, which are non-equity type joint ventures, which may include functional co-operation between companies by way of agreements providing intellectual property rights, know-how, etc. as well as other non-equity agreements.

In India, Joint Venture companies are the most preferred form of corporate entities. There are no separate laws for joint ventures in India. The companies incorporated in India, even with up to 100% foreign equity, are treated the same as domestic companies. A Joint Venture may be any of the business entities available in India.

The term "joint venture" has not been defined under any Act or legislation for the time being in force in India. However, the Hon'ble Supreme Court of India, in the case of *Faqir Chand Gulati vs. Uppal Agencies Pvt. Ltd. and Anr. [(2008) 10 SCC 345]* dealt with the issue of whether an agreement under which the builder agreed to make a housing construction for the land owner was a "collaboration agreement or a joint venture", or the activity of the builder squarely fell within the trappings of the definition of "service". It was observed by the Hon'ble Supreme of India that the title or caption or the nomenclature of the instrument/document is not the determining factor as regard the nature and character of the instrument/document and the true purpose of a document has to be ascertained with reference to the terms of the document, which express the intention of the parties. As such, the Apex Court made an attempt to define the term "joint venture" and held that the expression "joint venture" connotes a legal entity in the nature of a partnership engaged in the joint undertaking of a particular transaction for mutual profit or an association of persons or companies jointly undertaking some commercial enterprise wherein all contribute assets and share risks. Therefore, the use of the words 'joint venture' or 'collaboration' in the title of an agreement or even in the body of the agreement will not make the transaction a joint venture, if there are no provisions for shared control of interest or enterprise and shared liability for losses.

In *New Horizons Ltd vs Union Of India 1995 SCC (1) 478*, dealing with the question whether a particular company is a joint venture or not, the Hon'ble Supreme Court of India, rejecting the view of the High Court that a company cannot be called as joint venture when there is only a certain amount of equity participation by a foreign company, held that when apart from having equity participation, the Indian group of companies and the foreign based company have pooled together their resources and all the constituents of the company have thus contributed to its resources which shows

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that the Indian Company and the foreign based company is an association of companies jointly undertaking a commercial enterprise wherein they will all contribute assets and will share risks and have a community of interest, is a joint venture company. The SC held: "This shows that NHL is an association of companies jointly undertaking a commercial enterprise wherein they will all contribute assets and will share risks and have a community of interest. We are, therefore, of the view that NHL has been constituted as a joint venture by the group of Indian companies and I IPL, the Singapore-based company and it would not be correct to say that I IPL which has a substantial stake in the success of the venture, having 40% of shareholding, is a mere shareholder in NHL". As evident, in this ruling, sharing of risks, community of interests, contribution to assets and the intent to jointly run and undertaking were taken as indicators of a joint venture.

*In Gvprel-Mee (J.V.), vs Government Of Andhra Pradesh, 2005 (5) ALD 450, 2005 (5) ALT 325, 2005 (2) CTLJ 307 AP the Andhra Pradesh High Court lamented the lack of clarity on the concept of joint venture. The court stated: "No law on the Statute book of India or the State defines a joint venture, though under Section 8 of the Partnership Act, 1932, a person may become a partner with another person in particular adventures or undertakings. In case of such "particular partnership" it has its existence only till the purpose for which said partnership or adventure or undertaking came into being. It gets dissolved the moment the purpose for which the partners joined is accomplished and liabilities of persons joining in a particular partnership for the purpose of particular adventure would only last till such undertaking completes the purpose for which it is formed. Such particular partnerships are restricted to a single project in which the members of the group act jointly both at the stage of tendering and at the stage of awarding. Being unincorporated associations, common law did not recognise the relationship of co-adventures, but with the passage of time, the judicial decisions recognised what is known as "joint venture" of 'two or more persons/ undertakings to combine their property or labour in conduct of particular line of trade or a general business for joint profits."*

*In New Horizons Ltd vs Union Of India 1995 SCC (1) 478, the Supreme Court had the following to see about the meaning of joint ventures: The expression "joint venture" is more frequently used in the United States. It connotes a legal entity in the nature of a partnership engaged in the joint undertaking of a particular transaction for mutual profit or an association of persons or companies jointly undertaking some commercial enterprise wherein all contribute assets and share risks. It requires a community of interest in the performance of the subject-matter, a right to direct and govern the policy in connection therewith, and duty, which may be altered by agreement, to share both in profit and losses. (Black's Law Dictionary, 6th Edn., p. 839) According to Words and Phrases, Permanent Edn., a joint venture is an association of two or more persons to carry out a single business enterprise for profit (p. 117, Vol. 23). A joint*

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venture can take the form of a corporation wherein two or more persons or companies may join together. A joint venture corporation has been defined as a corporation which has joined with other individuals or corporations within the corporate framework in some specific undertaking commonly found in oil, chemicals, electronic, atomic fields. (Black's Law Dictionary, 6th Edn., p. 342)

In *Asia Foundations & Constructions Ltd. v. State of Gujarat: AIR 1986 Guj 185*, a division Bench of the Gujarat High court has dealt with the nature of Joint Venture and rights and liabilities of the Joint Venture partners at length. The relevant passage of the judgment may be reproduced hereunder:

*"The common law did not recognise the relationship of coadventures, but with the passage of time, the judicial decisions recognised what is known as 'joint adventure' of two or more persons undertaking to combine their property or labour in conduct of particular line of trade or a general business for joint profits. The Courts do not treat a joint adventure as identical with a partnership though it is so similar in nature, and in the contractual relationship created by such adventurerers that the rights as between them are governed practically by the same rules that govern the partnership. This relationship has been defined to be a special combination of persons undertaking jointly some specific adventure for profit without any actual partnership. It is also described as a commercial or a maritime enterprise undertaking by several persons jointly; a limited partnership not limited in the statutory sense as to the liabilities of partners but as to its scope and duration. Generally speaking the distinction between a joint adventure and a partnership is that former relates to a single transaction 'though it may comprehend a business to be to be continued over several years' while the later relates to a joint business of a particular kind (see 48 American Law Reports at p. 1055 under the caption "what amounts to a joint adventure" at pages 1056-57 and 1060). It is generally agreed that in order to constitute a joint venture, there must be community of interest and right to joint control. It is recognised on authority that each of the parties must have an equal voice in the matter of its performance and control over the agencies used therein, though one authority may entrust the performance to another. There is also an authority to the effect that a joint venture may exist although the parties have unequal control of operations. The rights, duties and liabilities of joint ventures are similar or analogous to those which govern the corresponding rights, duties and liabilities of the partners. As in the case of partners, joint ventures may be jointly and severally liable to third parties for the debts of the venture (see: American Jurisprudence, Second Edition, Vol.46, para 12 at pages 33-34 and para 57 to p.76). Joint Venture groups are internationally recognised in form of cooperation in the joint fulfilment of the construction contract obligations. Joint venture groups in the construction industry come*

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*about through agreements for combination of legally independent contractors for the joint rendering of construction services limited in both time and content. Typically they are restricted to a single project in which case the members of the group act jointly at both the tendering and award stages. Joint venture groups are generally unincorporated associations. The legal systems in general have not kept pace with the growing economic means of joint venture groups and there is no special legal form for this type of cooperation which has come to stay in construction industry.*

*The services to be rendered by the group are to be allocated amongst the members of the same by internal agreement, and consequently the rights and duties of the members inter se are also regulated by the group agreement. These internal agreements are not effective vis-a-vis the third parties, and they operate amongst the members inter se. Thus, all the members are jointly and severally liable for performance of the construction work jointly undertaken irrespective of internal division of the work. If one member of the joint venture group does not fulfil his commitments, the others are under joint and several obligation to carry out such obligations vis-a-vis the customer. Such a situation may arise when a member of a joint venture group drops out prematurely because of the liquidation or insolvency. When a contract is concluded with a joint venture group all members are made jointly and severally liable even if only one is capable of rendering the service in question. The joint and several liabilities of the members of a joint venture group may cover the marginal areas of the contract performance such as late performance, faults, deficiency of goods and services etc"*

*In Chahal Engg. and Construction Co. (P) Ltd. v. State of Gujarat, (1987) 1 Comp. LJ 1 (Guj.) (D.B.)* a Division Bench of Gujarat High Court was dealing with a case of joint venture where at the stage of consideration of pre-qualification to tender, one of the members of eight participants of joint venture consortium, withdrew from the group. The Gujarat High Court considered JV agreement and subsequent postils to it, came to the conclusion that even if one of the joint venture partners withdrew from the joint venture, still the joint venture continued to function. The relevant passage from the judgment delivered by Justice B.K. Mehta is reproduced follows.

*"The case, therefore, is not of termination of the joint venture agreement or it ceasing to be in effect on the expiry of 12 months, but is virtually a case of withdrawal by one of the co-venturers. The question which, therefore, arises is whether a co-venturer is entitled to withdraw before the purpose of the venture is accomplished or has failed; and if he does not do so, what is its effect? Whether a party has a right to withdraw and what is the effect of such withdrawal upon the Joint venture depends upon the terms of the agreement and/or upon the circumstances. Generally, no co-venturer has a right to*

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*withdraw from or abandon it without the consent of his co-venturers where the venture has not fulfilled its purpose. In absence of a decree of a Court or on an agreement fixing the time of termination or voluntary abandonment of the enterprise by one of the co-venturers, the joint venture agreement remains in force until its purpose is accomplished or becomes impossible for fulfilment and while it is in force, ordinarily, one joint venturer has no right to withdraw himself from the arrangement. It is only where the joint venture agreement is silent about this duration or termination, that a co-venturer has right to withdraw, since it is virtually a limited partnership at will. Even the abandonment of a joint venture by one of the participants, and his active opposition to its operation by his co-venturers will not forfeit his interest in the enterprise or deprive him of his right to share in the profits."*

Thus on going through the aforesaid decision of the Hon'ble Supreme Court of India and two judgments of Gujarat High Court, it may be summarised that an informal partnership between two or more persons to take up a common enterprise on one time basis is a 'joint venture'. The 'joint venture' involves the factors, like (i) contribution by the parties of money, effort, knowledge and other assets to common undertaking; (ii) joint property interests in the subject matter of the venture; (iii) right of mutual control of management of the enterprise; (iv) expectation of profit; (v) right to participate in the profits; and (vi) limitation of the objective to a single undertaking.

On the issue of whether a tender granted on the basis of joint venture remains valid has been discussed in an Andhra Pradesh High Court's ruling in *Gvprel-Mee (J.V.), vs Government Of Andhra Pradesh, 2005 (5) ALD 450, 2005 (5) ALT 325, 2005 (2) CTLJ 307*. The Hon'ble Court held that on a withdrawal of a Joint Venture partner, the joint venture gets dissolved while observing: "*Therefore, this submission of the learned counsel that even after the withdrawal of MEE, Joint Venture continued to exist cannot be accepted. It must be remembered that the company incorporated in the nature of joint venture may not lose its juristic personality. Similarly a registered partnership firm under Partnership Act may still have certain obligations, rights and liabilities, even after dissolution, by reason of Sections 45, 46 and 47 of Partnership Act, 1932. The same is not the position in the case of Joint Ventures which came into existence by reason of agreement between two or more Joint Venture partners. When there are only two partners in the Joint Venture, and one of them goes out, it is very difficult to accept such entity as a continuing Joint Venture especially when it only draws its sustenance under a mutual agreement between the two partners.*" Distinguishing the case from one before the Gujarat High court DB ruling above, the court drew analogy of a vehicle - a bicycle having 2 wheels falls if one wheel is taken out - however, that is not the case in case of a 6 wheeler vehicle.

A Joint Venture may be formed between two companies, either with or without equity participation; both the situations may be briefly discussed as under:

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- **Ventures without Equity Participation:** If a joint venture between two companies is formed without equity participation, then in reality, partnerships are formed in which companies pool resources and maintain their respective identities. Ownership remains in the hands of each partner. One of the main advantages of engaging in non-equity venture is that they give new or foreign markets that may not otherwise be effectively accessible because of governmental barriers to foreign firms and a network of domestic enterprises that do not welcome newcomers.
- **Ventures with Equity Participation:** In the joint venture with equity participation, each company has an invested equity stake in the joint venture. This is in contrast to the other venture, in which companies contribute machinery, technical know-how or even money but do not contribute in a joint ownership venture.

### Distinction between Joint Venture, Collaboration and Merger

IAS 31 defines a Joint venture as a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint control implies contractually agreed sharing of control over an economic activity such that no individual contracting party has control.

A Collaboration on the other hand is a layman's term and is not part of any accounting standard. It just means the coming together of two or more parties for the purpose of brainstorming and sharing of expertise.

In *Continental Construction Ltd. And Ors. vs State Of Gujarat And Anr. AIR 1987 Guj 66, (1986) 2 GLR 884*, the Gujarat High court elaborately cited the ruling in *Asia Foundation and Construction*, and based on facts, essentially the joint and several liability of partners, held that the case was not one of collaboration but was one of joint venture.

In a merger, two separate companies combine and only one of them survives. In other words, the merged (acquired) company goes out of existence, leaving its assets and liabilities to the acquiring company. Usually when two companies of significantly different sizes merge, the smaller company will merge into the larger one, leaving the larger company intact. Mergers are part of Business Combinations, the subject of IFRS 3.

### Meaning of Joint Venture as per the Indian Accounting Standard

The Indian Accounting Standard 27 which was formulated by the Institute of the Chartered Accountants of India deals with the Financial Reporting of Interests in Joint Ventures.

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Joint ventures may take different forms and have many structures. This Statement identifies three broad types - jointly controlled operations, jointly controlled assets and jointly controlled entities - which are commonly described as, and meet the definition of, joint ventures. The following characteristics are common to all joint ventures:

- two or more venturers are bound by a contractual arrangement; and
- the contractual arrangement establishes joint control.

### **Three examples of joint venture as per Accounting Standard 27**

#### **Jointly Controlled Operations**

The operation of some joint ventures involves the use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer uses its own fixed assets and carries its own inventories. It also incurs its own expenses and liabilities and raises its own finance, which represent its own obligations.

#### **Jointly Controlled Assets**

Some joint ventures involve the joint control, and often the joint ownership, by the venturers of one or more assets, acquired for the purpose of and contributed to the joint. The assets are used to derive economic benefits for the venturers.

#### **Jointly Controlled Entities**

It means the establishment of a company, corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other enterprises, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity. For example an entity is said to be jointly controlled when two enterprises combine their activities in a particular line of business by transferring the relevant assets and liabilities into a jointly controlled entity. Another example is when an enterprise commences a business in a foreign country in conjunction with the government or other agency in that country, by establishing a separate entity which is jointly controlled by the enterprise and the government or agency.

**The 3 types of joint ventures represent 3 degrees of entities coming together**

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- In the first example stated above, there is a separate ownership of resources, only the pooling of operations takes place.
- In the second example, there is a joint ownership of resources but no separate entity.
- In the third example, there is a formation of separate entity but the same is controlled jointly.

### Indicators of joint control

There should be some indicators of joint control. Firstly there should be an existence of some arrangement or understanding and which is done usually through a written document, may be in form of minutes or agreement. In case of companies, provisions in its Articles of Association are generally provided. Secondly the said written document should provide for joint control and while one person may be the operator, single person does not have control over the entity.

### How to find out whether a joint venture exists

There are some key distinctions between a joint venture and a partnership concern. While a partnership concerns ongoing business in all regards, a joint venture only concerns a single project or a related series of transactions. Here are some other characteristics of joint ventures:

- **Profits and Losses** - Unless otherwise agreed to, joint venturers share profits and losses equally.
- **Duration** - A joint venture terminates upon the completion of the project or series of transactions in the absence of the contract to the contrary.
- **Termination** - Unlike a partnership, a joint venture does not terminate upon the death or incapacitation of one joint venturer. A joint venturer does have the power to terminate the relationship at any time once the project or transaction is complete.
- **Formalities** - Unlike partnerships, joint ventures don't have to file information returns.
- **Not just an Investment** - JVs are typically not a passive investment. Generally the parties need to contribute skills as well as money.
- **Single Business** - JVs are typically for a single business, development or project rather than a long term relationship between the co-venturers.
- **Extension to the Main Activity** - JVs usually are not the major activity of the parties concerned. If they're individuals they'll have day jobs. In the business world they'll have a core business to which the JV is an adjunct typically. The JV is a collaborative extension of their commercial activities.

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- **Regulated by a written document** - The association between the participants is almost invariably regulated by a written agreement called a Joint Venture Agreement (JVA).

The existence of a joint venture "may be based upon a rational consideration of the acts and declarations of the parties, warranting the inference that the parties understood that they were [co-adventurers] and acted as such." [*Davis v. Davis*, 58 N.C.App. 25, 30, 293 S.E.2d 268, 271 (1982) (citing *Eggleston v. Eggleston*, 228 N.C. 668, 674, 47 S.E. 2d 243, 247 (1948))].

The Hon'ble Supreme Court in *Addanki Narayanappa v. Bhaskara Krishnappa*, AIR [1966] SC 1300, at page 1304, laid down:

*"The whole concept of partnership is to embark upon a joint venture and for that purpose to bring in as capital money or even property including immovable property. Once that is done whatever is brought in would cease to be the exclusive property of the person who brought it in. It would be the trading asset of the partnership in which all the partners would have interest in proportion to their share in the joint venture of the business of partnership. The person who brought it in would, therefore, not be able to claim or exercise any exclusive right over any property which he has brought in, much less over any other partnership property. He would not be able to exercise his right even to the extent of his share in the business of the partnership."*

### Rights of Joint Venturers

Parties in a joint venture have certain rights. Such rights include:

- **Equal control**- Equal power, control and influence over the joint venture project or transaction. However, the contract can give one party complete control.
- **Equal Ownership**- Equal ownership of the project (and thus equal shares of profits and expenses).

### Duties of Joint Venturers

Parties in a joint venture have duties to one another. Such duties include:

- **Fiduciary duty** - A fiduciary duty basically means that each party to the joint venture is duty bound to act in the best interests of all involved. Acting for your own best interests is a breach of fiduciary duty and the same may also constitute

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a breach of contract if the joint venture was formed by a contract. In a widely cited case of *Meinhard v. Salmon*, 164 N.E. 545 (N.Y. 1928), it was held by the New York Court of Appeals that partners in a business have a fiduciary duty to inform one another of business opportunities that arise.

- **Joint Liability** - If a third party is affected by the joint venture, all parties involved are equally liable. For example, a joint venture is formed for the purpose of constructing a building. During the course of construction, a brick falls and injures a pedestrian then all joint venturers would be liable for the pedestrian's injury.
- **Disclosure** - All information pertaining to the joint venture shall be disclosed to the parties involved. It should be made sure that the contract clearly specifies what information each party is required to disclose. Under the Federal securities laws, even preliminary discussions between parties to a potential joint venture may be subject to disclosure by one or both the parties. However the Supreme Court of the United States, in *Basic Inc. Vs. Levinson*, 485 U.S. 224, 231-232, held that disclosures of fundamental corporate transactions will depend at any time on the balancing of both the indicated probability that the 'event will occur' and the 'anticipated magnitude of the event' in light of the totality of company activity.

### Entering into a Joint Venture Agreement

The key to the success of any joint venture lies in the selection of a good local partner. Once a partner is selected generally a Memorandum of Understanding or a Letter of Intent is signed by the parties.

A Memorandum of Understanding and a Joint Venture Agreement is to be signed after going through wide ranging consultations with legal professionals well versed in international laws and multi-jurisdictional laws and procedures.

In case of those joint ventures where a new corporate entity for example a company is created, the typical agreement in such a case is the shareholders' agreement

Ideally a Shareholders' Agreement should contain the following clauses:

- i. The parties involved
- ii. A brief recital
- iii. Definition and Interpretation clause
- iv. The effective date of the Agreement

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- v. Capital Structure
- vi. The object, purpose and scope of the joint venture
- vii. Management and the Board of Directors
- viii. Composition of Board of Directors
- ix. Shareholders' Rights and Obligation
- x. Representations and Warranties
- xi. Termination of the Agreement
- xii. Confidentiality
- xiii. Miscellaneous Clauses; which include
  - Notices
  - Force Majeure
  - Specific Performance & Obligations
  - Governing Law and Consent to Jurisdiction; Arbitration etc

The Deed of Adherence also forms part of the Shareholders' Agreement as an Annexure to it.

### **What is a Deed of Adherence?**

A Deed of Adherence is used when a new shareholder joins a company which has a shareholders agreement in place between its shareholders. This Deed is commonly used when shares of one shareholder are transferred, whether by way of sale or by gift to someone who isn't already a shareholder.

Any shareholder who wishes to dispose of their shares or transfer them to another person must check with the original Shareholders' Agreement whether they are able to do this or not since in some cases the Shareholders' Agreement does not permit the transfer of shares to another person/s.

The company will assess if the person obtaining the shares is permitted to hold such shares. The company will also check to see if the shareholder is registered and that they have entered into a Deed of Adherence. The new shareholder will be bound to the original Shareholders Agreement under the Deed of Adherence.

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It is significant to note here that the company cannot register the individual as the new shareholder until the shares are formally transferred through a Deed of Adherence. If there is no formal transfer of shares through a Deed of Adherence, the shareholder will be in breach of the provisions of the original Shareholders' Agreement.

### Special Clauses in the Share Holder's Agreement

Apart from what has been mentioned above, there some special clauses that should be incorporated in the share-holder's agreement and which broadly include the following:

- **Right of First Refusal:** A Right of First Refusal in a Shareholder's Agreement is a contractual right that obliges the selling shareholder not to sell its shares in the company to a third party without first offering his shares to another party who is usually an existing shareholder/s. If the existing shareholder/s does/do not accept the offer, selling shareholder is free to sell his stake to any third party, provided that the sale is not on more favourable terms than those offered to the existing shareholders.
- **Right of Pre-emption:** As compared to 'Right of First Refusal', there is an almost similar right which is known as a pre-emptive right or right of pre-emption. For this right to be effective and enforceable, in the case of a private company, the same may be inserted in its Article of Association. As per the said right, there are restrictions imposed on the right to transfer shares. However it is imperative to highlight that the restriction upon the right to transfer shares to outsiders does not by itself operate as a pre-emptive clause. Rather to create a pre-emptive clause, it is necessary to create duty on the part of the seller member to offer his shares by a designated mechanism to other members.
- **Drag-Along Right:** Drag-Along Right is a legal concept in corporate law. This right means and implies that if the majority shareholders sell their stake, then the minority shareholders are forced to join the deal. The term 'dragging' refers to the majority shareholders forcing the minority shareholders into an agreement that the minority shareholders may not want to enter into. This right is basically designed to protect the majority shareholders. One of the apparent reasons for the same may be that some buyers/investors are only looking to have complete control of a company, drag-along rights help to eliminate minority owners and sell 100 percent of a company's securities to the buyers.
- **Tag Along Right:** Tag Along Right which is also sometimes referred to as 'co-sale rights' assures that if the majority shareholders sell their stake, the minority shareholders have the right to join the deal and sell their stake at the same terms and conditions as would apply to the majority shareholders. This right protects

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minority shareholders as tag-along rights effectively oblige the majority shareholders to include the holdings of the minority shareholders in the negotiations in order to facilitate the possibility that a tag-along right is exercised.

In the celebrated case of *V.B. Rangaraj vs. V.B. Gopalakrishnan [1992] 73 Comp Cas. 201*, the Hon'ble Supreme Court of India delivered a landmark judgment and held that a restriction which is not specified in the Articles of Association is not binding either on the or on the shareholders. The court further held that the agreement (as in the said case) imposed additional restrictions on the member's right of transfer of his shares which were not stipulated in the articles and, therefore, were not binding either on the shareholders or on the company. It was also held that the shares are movable property and transfer thereof is regulated by the Articles of Associations of the company.

In relation to private companies, the Court has held that because the shareholders are deemed to have constructive notice of the articles, any restrictions or terms contained in an agreement between the shareholders of the company, but not reflected in its Articles of Association, are not binding on the company or its shareholders.

Further, as regards a public company, the Court held that even if the Articles of Association provide for a 'Right of First Refusal', if the right is a restriction on the free transferability of shares and not a mere process, then it is not likely to be enforceable.

In coming to the aforesaid conclusion, the court *inter alia* relied on the decision given in *Kinetic Engg. Limited Vs. Sadhana Gadia [1992] 74 Comp. Cas. 82*, wherein it was held by the Company Law Board that if any provision of the Articles of Association is contrary to any provision of law, it will be held invalid.

Further the Hon'ble Bombay High Court in *IL & FS Trust Co. Ltd. Vs. Birla Perucchini Limited [2003] 47 SCL 426*, held that the provisions in an agreement, cannot be given effect to insofar as the management of the affairs of the company is concerned, unless those provisions have been incorporated into the Articles of Association. The fact that the company is a party to the subscription agreement (as in this it was) makes no difference to this position because the same is well settled in law.

### Conclusion:

Embarking on a Joint Venture can represent a significant reconstruction to your business. No matter how favourable the growth prospects of your adventure are, it must fit with your overall business strategy.

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Review of your business strategy is *sine qua non* before committing to a joint venture. This should help you define what you can sensibly expect. In fact, you might decide there are better ways to achieve your business aims.

You may also want to study what similar businesses are doing, particular those that operate in similar markets to yours. Seeing how they use joint ventures could help you decide on the best approach for your business. At the same time, you could try to identify the skills they use to partner successfully. You can benefit from studying your own enterprise. Be realistic about your strengths and weaknesses - consider performing strengths, weaknesses, opportunities and threats analysis to identify whether there is compatibility between two businesses. You will almost certainly want to identify a joint venture partner that complements your own skills and failings.

Always try to consider from the employees' perspective and bear in mind that people can feel threatened by a joint venture. It may not very easy to foster effective working relationships if your partner has a different way of doing business.

Small business owners should not engage in joint ventures without adequate planning and strategy. Since the ultimate goal of joint ventures is the same as it is for any type of business operation, they cannot afford to make much profit. Experience tells us that both parties in a joint venture should know exactly what they wish to derive from their partnership. The presence of *consensus ad idem* in all aspects of joint venture is extremely important to have a fruitful result of their adventure. There must also be a firm commitment on the part of each member to the project and to one another. One of the main causes for the failure of joint ventures is that some participants do not reveal their true business agendas, or mislead their partners about their ability to uphold their agreed-upon responsibilities.

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