

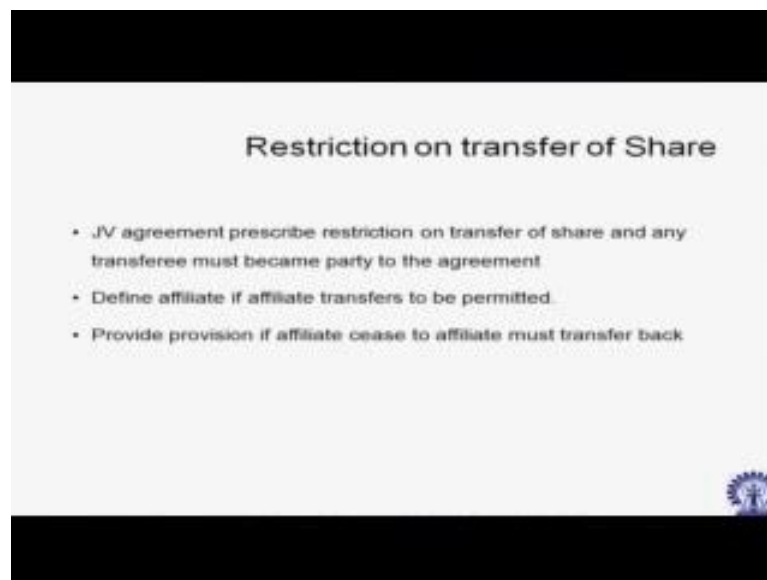
Technology Transfer through Joint Venture
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Lecture – 15
Specific Issues of Share Transfer in Joint Venture

I will welcome you in my 15th lecture, relating to technology transfer through Strategic Alliance and Joint Venture. I was talking with you relating to Joint Venture agreement, and, I have discussed several issues relating to the Joint Venture agreement, like matter of the governance, business plan, then, in my last lecture I talked with you about share holder's agreement.

In this lecture, I will concentrate more on specific issues of share transfer, in Joint Venture. And these issues are basically consequence of the share holder agreement, or rather I should say, you should include these particular issues in the share agreement, to avoid the future difficulties in the Joint Venture.

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So, first of all, I like to draw your attention relating to the restriction of transfer of shares, restriction on transfer of shares. So, in the Joint Venture agreement, there might be some kind of restriction provided, relating to the transfer of the shares, and who can be the transferee, of that particular shares. Transferee means that can you the transfer the share to another venturer or if you transfer the share to another venturer, in what conditions

you can do that. Now please consider, when I am talking about another venturer, there might be more than 2 venturers. So, if there is a 3 venturer, or 4 venturer, or 5 venturer in that particular Joint Venture, then you might create a provision, which specifies, then in what circumstances you can transfer the shares, to whom.

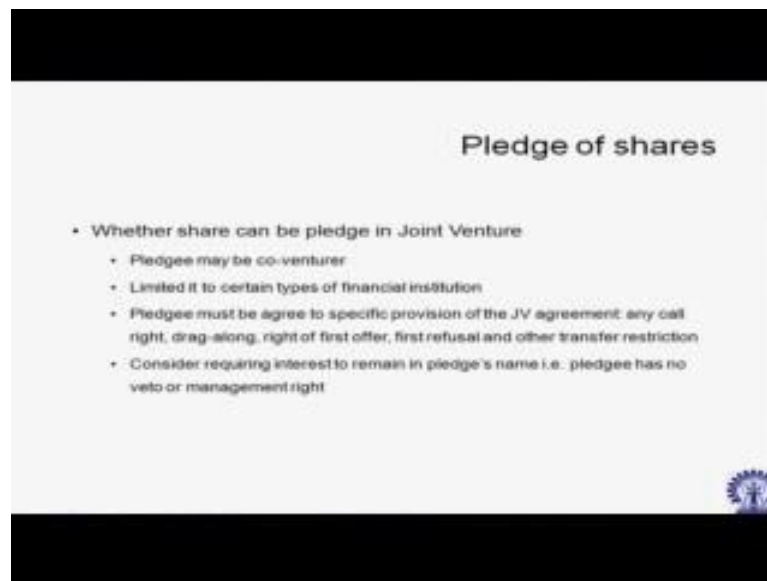
Next important thing is that, can you transfer the shares, beyond the Joint Venturers in that particular venture? That means, can you transfer the shares to third party, who is not party to that particular Joint Venture? And if you allow so, then in that case in what circumstances you allow that? Yesterday, I have talked about this particular issue, on some extent, but this is a contentious issue, because many of the times it might so happen, that for the regulatory reason, you need to withdraw from the particular market. And if you have a foreign market, foreign venturer, then in that case regulatory might prescribe even, that after passing of the certain time, you need to reduce your holding. So, in those circumstances how we are going to transfer your stake to the third party, if the existing venturers are not interested to purchase the shares or, existing venturers are interested to get a new partner into that particular Joint Venture, ah, itself.

Now, the next important issue which is related to this is selecting of the affiliates. Now will you allow your subsidiary, to joint, in the Joint Venture? So, important thing is that, who is an affiliate that needs to be defined? So, is it the subsidiary will be which will be called as affiliate? Or is it the member of a group company, will be called as affiliate? Is it that, you have a business associate with whom you have a Strategic Alliance, he will be called, or, I mean, it will be called as an affiliates to you? So, defining the affiliate is very important, and in what condition, and in what terms, the shares can be transferred to the affiliate, that is also one of the important issues to be included, in the Joint Venture agreement.

Next issue is, if the affiliate sees to exit; that means, you are a Strategic Alliance, who is who was the affiliate in this particular Joint Venture, and because of his status of the affiliate, he acquired some kind of controlling stake, or may be, ownership, into this particular Joint Venture organization, and then, for one or other reason that particular affiliate cease to be affiliate; that means, the Strategic Alliance, with a one of the venturer is no more exist.

Then in that case, what should be the consequence? Is it that the affiliate has to sell the shares back to the existing Joint Venture? Or affiliate will have a right to sell the shares into the open market? Or the affiliate cannot exist that particular venture until a particular time is expire. So, what where the process issues you need to spell it out in the Joint Venture agreement itself.

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Now, let me take you to the next point, relating to the pledge of shares. And you will find in today's world, the pledge of shares is became a one of the very important issue, for the purpose of corporate borrowing. And, many of the time, the pledge of the issue, pledge of the shares is help promoters to, get a required financing, for the short term, or even for the purpose of working capital too. So, whatever the circumstances is, there need to define, the pledge is right. Now you might be wondering what is the pledge is all about, and under which law it governs.

Now in the simplest term, pledge means, giving the shares of the company as a security, for the purpose of raising the loan. And legal term, it says that you are keeping the movable property, as a security, to secure a loan. And this particular pledge is actually governed by Indian Contract Act. So, what kind of pledge you, the co venturers can exercise, you need to detail out within the Joint Venture agreement itself. So, you have to determine that, who can be the pledgee; that means, who can keep these particular

shares, and keep the loan. Is it that the venturer, co venturer itself? Is it that a financial institutions.

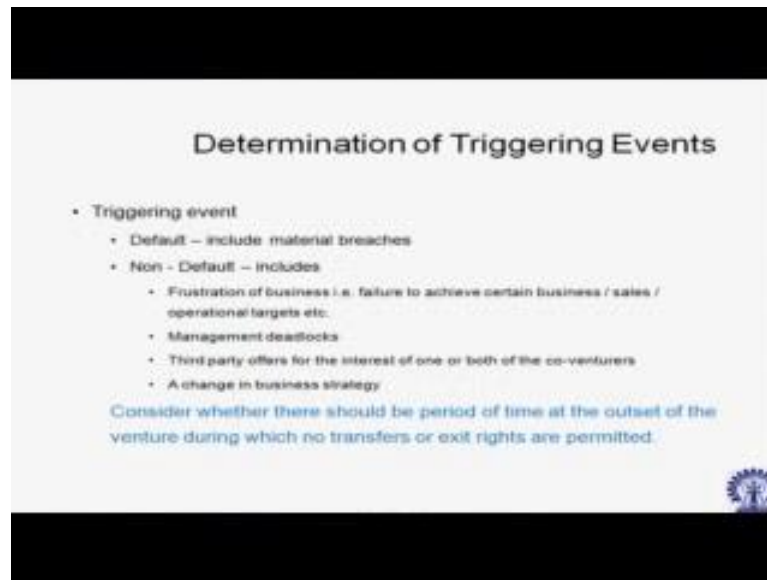
Now if I say it is a financial institution then, you need to specify, what kind of financial institution. Is it required to be a Schedule bank? Is it required to be a Public Financial Institution? Is it a Corporation bank? Can you pledge the shares to private NBFC's. So, what kind of financial institutions you are looking for, that you need to specify.

Next thing is that, the pledgee must agree to the specific provisions of the Joint Venture agreement. That means, if there is any Call Right, or drag along right, or right to first refusal, or right to first offer, or other transaction right, you should be agreed on that thing. Now I have named many of the right, which I am going to discuss with you in the subsequent part of my lecture. Because these are the specific right, which is developed through the contractual process, or through the conditionality in the Joint Venture agreement and now, and for your information, these particular you know rights, or the standards which has been developed over the years, as a Joint Venture practice, in a different market, and this is now quite standardized, as a part of the Joint Venture agreement too. Sometimes, these particular rights are governed by the existing law of the jurisdiction where you want to incorporate your organization.

And most of the time, this is governed by Joint Venture agreement itself. So, whatever the kind of right you get, pledgee should have some restriction or should be subjected to this particular right. So, pledgee cannot override this particular right. When some shares has been pledge to him for the purpose of a loan, or to use it as the purpose of the security. Now the next important thing is, considering requiring the interest, which will remain with the pledgee. Now pledgee will have a limited right. Now again I am repeating, who is the pledgee? The person who is holding the shares of a venture, as a security, and the pledger should always continue with the original right, which is given to him, or her, under the Joint Venture agreement. So, this right include, right to veto, management right etcetera. And generally you should see, that this particular right should be confer on the pledger. And will, this cannot be taken out, by the pledgee, by the pledge agreement. Because if it is given to the pledgee, sometimes it might create a difficulty even, the even running of the JV, or, it might be a potential difficult for governance of the JV.

So, you should always make it sure, that, the pledger should continue with the original right, even if the share has been pledged to a pledgee, for the short term or purpose of securing the debt.

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Now, let me take you to the next issues, which is generally known as determining of triggering events. Now when I am talking about determining of triggering effect events, I am basically indicating those circumstances, where either by default, or certain non default scenario, determines the Joint Venture so. That means, the partner basically severs the rights, in that particular Joint Venture, and they realize their asset, and whatever the rights they have, in the particular Joint Venture. And in generally, the triggering events are divided into a two broad category, that is a default, and there is a non default.

Now, defaults are those particular scenarios, where, the one of the Joint Venturer committed a breach, to the Joint Venture agreement. And that particular breach should be of a material nature. Now, this breach of a particular nature is purely a legal understanding. But let me simplify for your understanding. Breach of material interest means, that there is a certain condition, in that Joint Venture, are of such important, that if you breach those particular conditionality, or the condition, or the terms, in the Joint Venture agreement, it actually affects the right of the co-venturers. To the extent, that it is difficult to continue with that particular Joint Venturer itself. So, if co venturer commits

a breach, of the conditionality of a Joint Venture agreement, then it is treated that, it is a default condition of severity, of the Joint Venture partner, in the Joint Venture agreement.

Now let me talk about the non default events, or the circumstances, Non default event or circumstances are such, which is more of externality, to this particular Joint Venture agreement. That means, parties are trying to comply, the conditionalities, but there is some external condition, or may be in some cases, some internal condition, which dividing (Refer Time: 16:14) the party to continue further with this particular Joint Venture agreement. Now, if there is a failure, frustration in the business. Frustration in terms of failure of achieving certain business, sell, operation target, etcetera; That means, you have brought a product into market, or technology in a particular market, and you thought that people will be a responsive to this particular product which is coming out of the technology, because you are using a superior technology, and the product is a superior in nature.

But that particular product might not be accepted a lot, by the consumer into that market, because of several external factors. Like it might be the cost, cost has gone up because of the regulatory reason. Or was the tax reason of that particular place. It might be consumer habit, it might be, the preference of a heterogeneous consumer in that particular market. So, there could be several reasons, which frustrated business. Second aspect which is more internal, if there is a deadlock in the management, and neither of the management, is ready to negotiate, the deadlock scenario. Then again, again there is a possibility to get the frustration into that particular business.

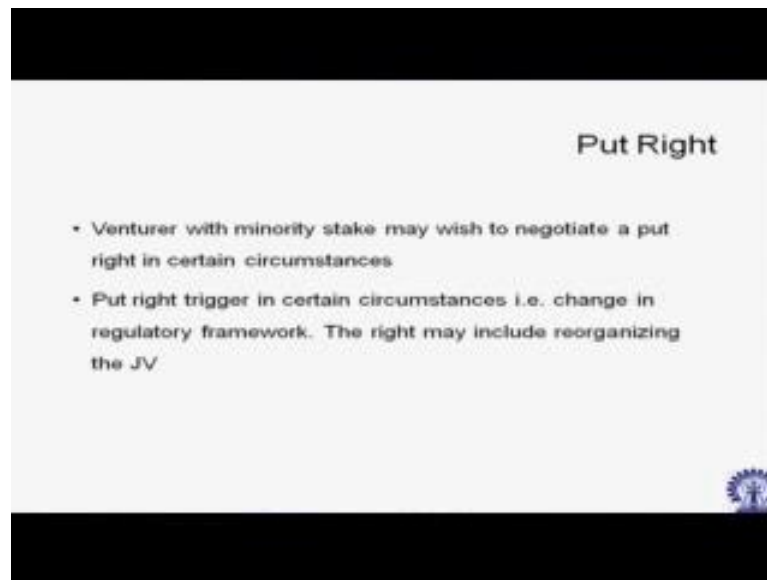
Next might be, that the third party offers for the interest, to one or both of the co venturers. And one of the venturers are interested to sell a stake, to the third party, and the other venturers think that if the particular venturer exit from the business, it might affect the Joint Venture severely. Because, this venturer might have brought some crucial thing to that particular venturer, on which this particular venture is based. Now it might be the technology, which is crucial to the business it might be type of investment, which this particular venturer brought into this venturer, it might be the market knowledge, which the venturer brought into that venturer.

So, that means, something which is very crucial for the success of that particular venturer. And that particular venturer is exiting, the Joint Venture, and wanted to sell it to the third person. Next one is, a change in business strategy. You have change in the business strategy, because of several reasons. It might be change in a regulatory environment, it might be the change in a technology, it might be change in a consumer preference and it might be change in the level of concentration in the market. So, because of the several reason you find that well, there is a, there is a change in the market structure.

And in those circumstances it is difficult for you to survive. And in those circumstances again, you, you decide to to you know, get yourself parted from the venture. Now whatever you, do either it is a default condition, or non default condition. You might define about the life about this particular venture. Because there is several issues which are attach with it. May be it might be lending issues which are attached with it. It might be the regulatory aspect.

Wherein it might say a regulatory, you know, in the, if you look into the foreign direct investment, or you know, other foreign policy, wherein it prescribed, that the foreign partner, need to continue, with the investment for at least 5 years before the withdraw from that particular market. So, there might be a lot of boundary condition, which compel the venturer to continue for certain years of time, or certain period of time, or even there might be the internal condition, or the business environment, or the business stakes. Because of that you need to continue this particular venture for some point of time.

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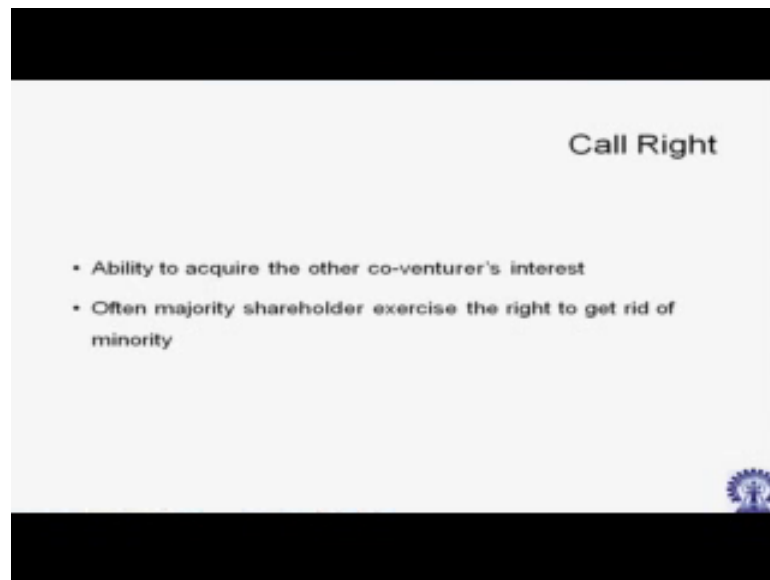


Now, let me take you to the next issue of, Put Right. Now, you will find, there is a two concept, which is used in in a simultaneously, one is known as a Put Right, other is the Call Right. Generally Put Right is given to the minority stakeholder in a Joint Venture. I have discussed with you other day when I was talking about the ownership structure. In a Joint Venture there might be somebody, who has a majority stake, and somebody who might you has a minority stake. So, Put Right is given to those particular person who are having a minority stake, or it can negotiated by the minority stakeholder, or minority share holders while they are entering into a Joint Venture agreement.

And Put Right includes the several issues. Like if they wanted to go out of the venture, what price they are going to get? How they can, whom they can sell this shares? How they can decide the values of their other rights in that particular venture? Like if you remember yesterday I was talking about issues of the technology; if you develop certain technology in the venture, who will have the ownership, this kind of right.

So, Put Right generally triggers, in change, change in a regulatory framework. And once there is a change in a regulatory framework, you need to, reorganize or restructure the JV. So, Put Right is actually sort of a protection, which is given to the minority stakeholder in the JV.

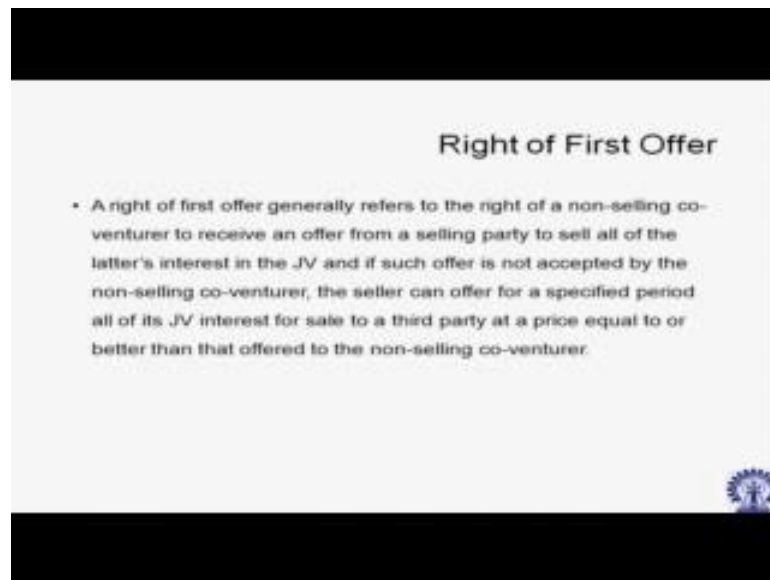
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Now, again you will find there is a Call Right. Call Right is basically, goes to the majority. Call Right gives the right to other venturer or ability to other venturer, to acquire the stake or shares, from the minority venturers. And, to give the, give them a right to exercise the all right, or call options so, that they can get rid of a minority share holder, whom they might think, are no more requires, or creating an obstacle, for the growth of the venture. So, Put Right is for the minority in the venture, whereas, the Call Right is the majority in that particular venture.

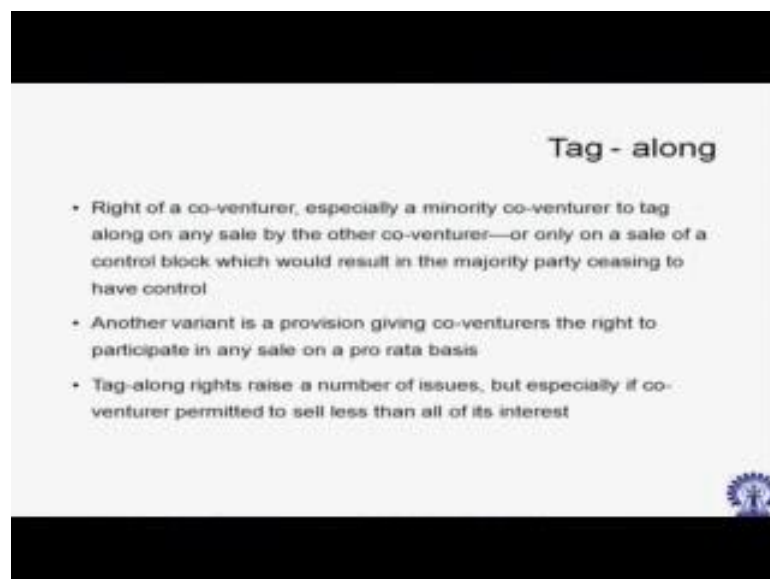
And in both the cases I have told you little before, you need to talk about the pricing of the shares, which are the shares can be sold, in what manner. What kind of consideration you can give? Can you give cash? Or can you give some other type of instrument? How you are going to value the shares? Because please remember, the valuation is difficult as I have discussed with you in the last lecture, if that particular company is a Private Limited Company, and are doing in a segment which is not very popular segment.

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So, the next, now let me take you to the next issues relating to, Right Of First Offer now Right Of First Offer and subsequently I will talk with you, Right Of Refusal which is basically known as Right Of First Refusal.

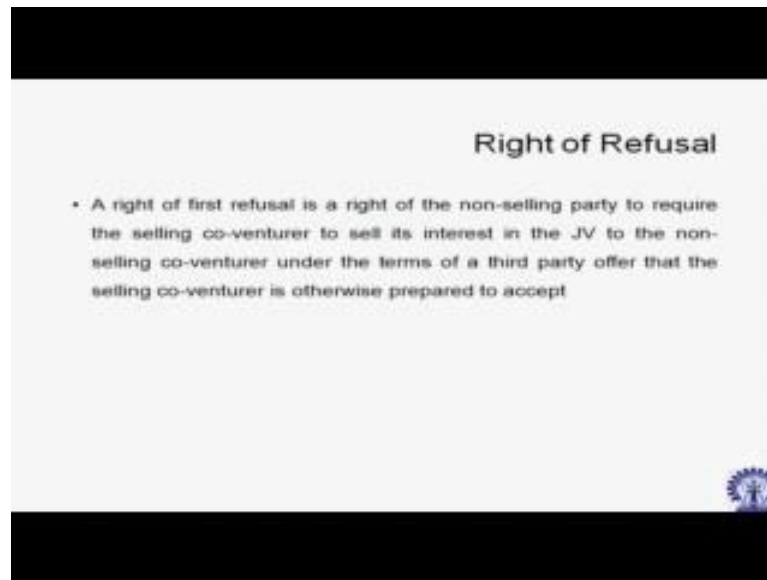
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In both the cases, this comes from, right which is otherwise known as predatory right. In this particular case of First Offer, the co venture who is selling its stake, need to offer to sell the stake to the existing co venturer. That means, if there is 2 co ventures, or 3 co ventures, let us take it like A B and C, and C want to exit from that particular Joint

Venture, then C need to make an offer to A and B to purchase that particular shares, or purchase its shares. So, that is known as the Right to First Offer. So, these venture can purchase that particular shares, and if you do not, then in that case they can the the C can sell the shares to the third person.

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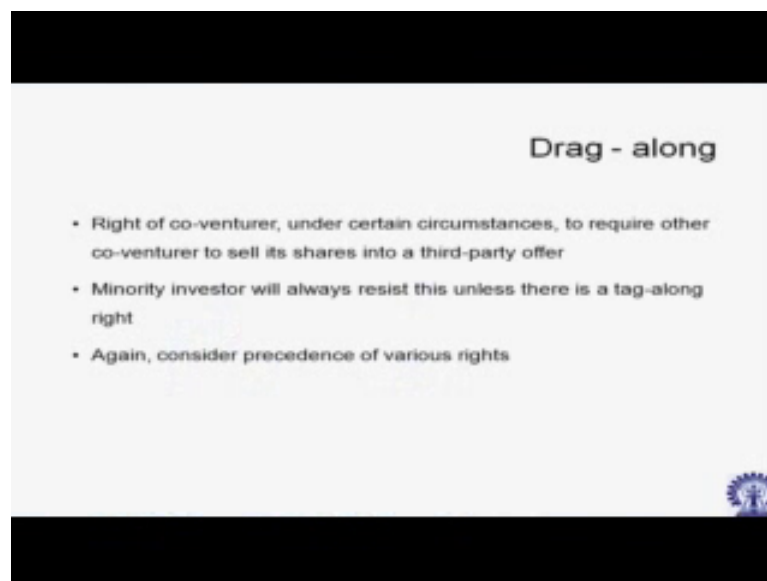


Now, if we are talking about Right to First Refusal, then in that circumstance, the co venturers make an offer to other co venturers, in the terms of the third party; that means, if the third party is making an offer to purchase the shares, to a co venturers, when the co venturers selling the share he is also taking the same kind, giving the same kind of offer, to the existing co venturers. That means, it will be a same kind of pricing, same kind of terms and condition. And this also give a kind of advantage for the existing co ventures, to know, what is the pricing of the shares, of that particular venture. So, many of the time you will find, the Right to First Offer, right, right, Right To First Offer, is less beneficial, than Right to Refusal. So, whatever, whatever you choose, that you are going to give a Right to First Offer or Right to First Refusal, you need to have adequate provision made, into the Joint Venturer agreement.

Now, let me come into the next issue, which is known as Tag Along. And simultaneously, you also use another concept called Drag Along. In case of a Tag Along, we give some special right to the minority co venturers, to Tag Along with any sales by other co venturers. That means what we are trying to tell you that, you need to give an

opportunity to minority share holder to exit from the venture, along with other co venturers, in the same kind of terms and condition. And you will find Tag Along right is raise, a number of issues, if the co venturer permitted to sell, less than all the interest. And this number of issues may include, the different kind of right you you have associated with, different kind of right which is associated, associated in this particular Joint Venture. It might be right relating to the ownership, right relating to the business plan, right relating to technology which has been developed so on so forth.

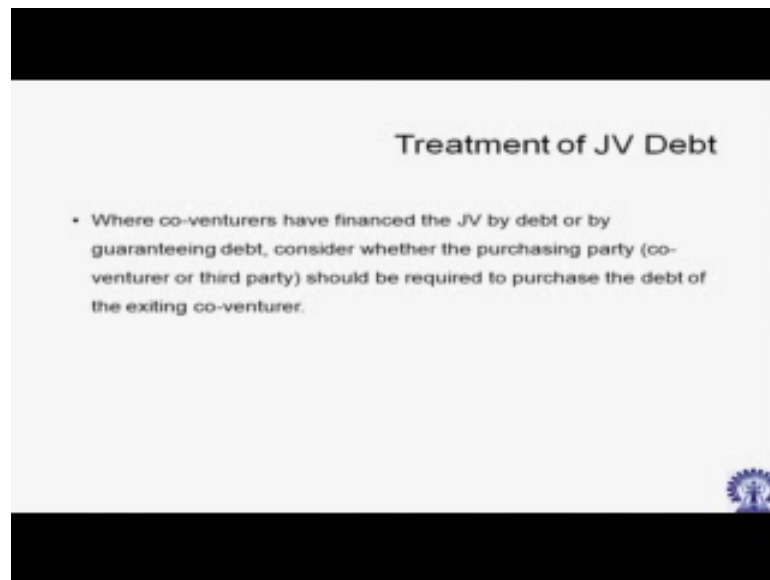
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Similarly, there is other concept, which we use called a Drag Along, and wherein, the co venturer in certain circumstances, require other co venturer to sell its share into a third party offer. So, that means, you have been dragged, even if you are not interested. Let me give example. You find in a venture, there is 3 venturers are there. 1 is a majority stakeholder, and other 2 are minority stakeholders. But these minority stakeholders, 2 minority stakeholder hold, more stakes, or more shares, in the Joint Venture than a single majority stakeholder.


So, third person might be interested to acquire the shares of both these you know venture, so, that he gets the majority right. So, that means, if you are, if you want to sell the shares, you need to drag another minority also with you, so that you can perform this particular transaction. So, that is called a Drag Along right, or you can have a provision relating to a Drag Along right adequately in your Joint Venture agreement.

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Treatment of JV Debt

- Where co-venturers have financed the JV by debt or by guaranteeing debt, consider whether the purchasing party (co-venturer or third party) should be required to purchase the debt of the exiting co-venturer.



Now, the next important thing is Treatment of Joint Venture debt. Now what the co-venturer have financed by the Joint Venture debt, or guaranteeing the debt, while purchasing the shares, by the co ventures. They need to purchase the debt also. That means, they need to take the liabilities also, if it is the third party, then also, the third party required to take the particular liability. And if you want to have this kind of provision, then that need to be incorporated in your Joint Venture agreement too.

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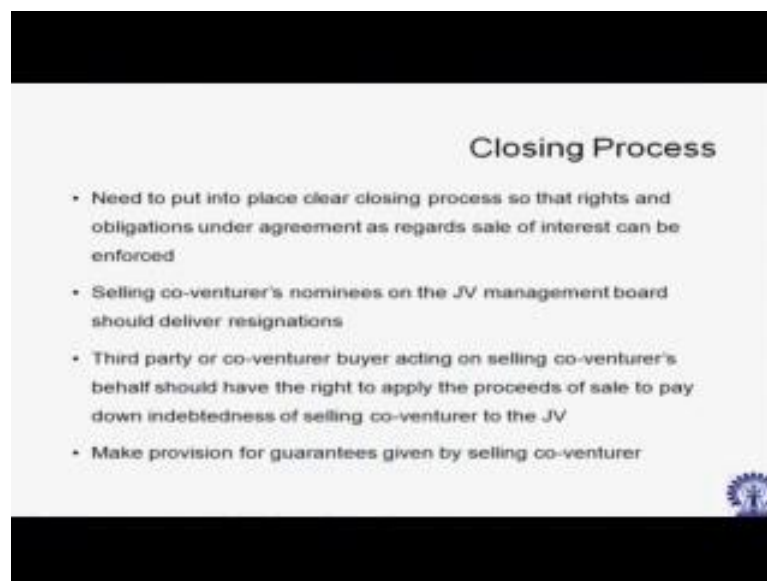
Regulatory Aspects of exit Transactions

- All exit transactions must be subject to regulatory compliance conditions
- Timing issues may arise where regulatory approvals are required to complete an exit transaction
- To the extent there may be conditions on the sale imposed by the approval agency, cannot force acceptance but consider requiring third party buyer or buying co-venturer to act in commercially reasonable manner
- Consider impact of any known (at time of entering into agreement) regulatory approval requirements on each type of possible exit scenario



Now, let me take you to the next one, relating to the regulatory aspect of exiting the transactions, and while you are exiting the transaction you need to comply with all the regulatory conditions. Timing issues may arise, where the regulatory approval is required, to complete an exit transaction, I told you a few minutes back. That the foreign direct investment policy might say that you cannot withdraw your investment, before a particular time period. Now you also need to consider other kind of impact, wherein, you need to have a regulatory permission for exiting the market.

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The next issue or most important issue is the Closing Process. So, whenever the parties to this particular venture close this Joint Venture, you need to go through the several processes. Because the Joint Venture may be for the specific years, and how you are going to close the Joint Venture that need to be defined under Joint Venture agreement, in a very clear terms.

So, you need to talk about, the obligation under the agreement, and how you are going to sell the interest, and how further it can be enforced. You need to talk about the nominees on the Joint Venture management board, you may need to talk about the third party co-venturer buyer co-venturer buying, buying or acting on behalf of any particular co-venturers. And you might need to talk about, the provision relating to the guarantee, which co-venturers, or warranty, which co-venturers is going to give during the sell of the co-venturer interest. So, the exit process is a complex process.

And in the exit process, it is always advisable that you should have a smooth transaction. Otherwise, it is difficult to realize, proceed out of that particular venture. And, the same may be, you know, bottleneck for your future venture too. So, I will advise to you, that you define the exit policy in a very clear terms, that during the exit you can avoid any kind of disputes, or the differences with your co venturers.

Thank you.