

Feature

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Joint venture agreements: part 14: involuntary expulsion of a JV party

KEY POINTS

- The provisions of art 17 allowing expulsion of a JV party, and buy-out of its JVCo shares, for certain causes, coupled with the hardship and review and *force majeure* provisions set out in arts 24 and 25, address some difficult potential future scenarios that go to the root of the purposes for which the JV was formed and provide for possible reconfiguring of the JV to overcome those circumstances.
- The use of the term 'important change' in referring to control, ownership, or optionally, management, creates ambiguity.
- There is a gap between the disenfranchisement of an excluded JV party and the buy-out of the excluded JV party's JVCo shares.

Article 17 provides the grounds and process to expel a JV party. It is a remedy of last resort. Any decision by the other JV parties to exclude a JV party must, under art 17.1, be unanimous.

Article 17.1 sets out four separate grounds to expel a JV party. The first ground, in art 17.1(a), is for material breach. The breach must be one the other JV parties 'consider is likely to prejudice materially the [JV's] business or success.' The non-defaulting JV parties must, under art 17.1(a)(i), notify the defaulting JV party of their intention to treat the breach as a terminating event if not remedied within a 'reasonable period.' They must also allow the defaulting JV party opportunity to cure, under art 17.1(a)(ii), and can only expel the defaulting JV party if it 'has failed to remedy that breach (or establish steps to prevent any recurrence) to the satisfaction of the other Parties within a reasonable period'.

Any attempt to expel a JV party for breach is likely to become caught up in the larger dispute over the breach. The accused party is likely to offer excuses and defences and may launch a counter offence. The issues of liability, causation and damages, and the possibility of counterclaims, may create an extended and contentious dispute resolution process. Of relevance to the process of expulsion, the issues in dispute may include whether the conduct complained of actually occurred as characterised, whether it in fact constitutes a breach, whether any excuses or extenuating circumstances relieve the defaulting JV party from liability, and whether the non-defaulting JV parties have acted reasonably. Any expulsion is thus more likely to play out in an arbitration or litigation proceeding than in a private, self-help action by the JV parties. Nevertheless, the contractual rights of expulsion afford a

This article is fourteenth in a series examining project development and finance joint ventures ('JVs') based on the International Trade Centre incorporated joint venture model agreement ('JVA') among three or more parties.¹ This instalment focuses on the circumstances in which a JV party may be involuntarily expelled from participation in the JV and as an owner of the joint venture company ('JVCo') and related excuses and defences. It covers JVA arts 17 (expulsion of a JV party), 24 (hardship and review) and 25 (*force majeure*).

remedy that may not otherwise be available.

The second ground for expelling a JV party, in art 17.1(b), arises if 'an important change takes place in the control or ownership' of a JV party. As an option, the JVA can also add a change in 'management' as a triggering event. Giving the remaining JV parties a 'call' on the JVCo shares of a JV party that undergoes a change in control or ownership is not unusual or unreasonable. As co-owners of a closely held business, they rightly have an interest in choosing their business partners. A change in ownership or control of a business partner can effectively be the same as a change in the identity of that business partner through a voluntary sale of shares (a topic discussed in the last instalment). By framing the remedy for change of control as one of 'exclusion' and bundling it with expulsion for default, however, the model JVA suggests that fault or adverse consequences must accompany the change in control for it to trigger expulsion. The lawyers for the JV parties might instead consider treating change of control separately from default so as to remove the emphasis on fault.

The use of the term 'important change,' in referring to control, ownership, or, optionally, management, also creates ambiguity. Is every change in control, ownership or management sufficiently 'important' to trigger the remedy? Unlike the 'material breach' ground for expulsion,

the 'change of control' ground lends itself to clear and objective definition. Adding the term 'important' undermines the ability of the remaining JV parties to make a clean decision to buy out the JV party that underwent a control change, while providing little comfort for the expelled JV party.

The third ground for expelling a JV party, in art 17.1(c), is triggered when a JV party 'has been excused from non-performance on grounds of *Force Majeure* for a period exceeding that specified in article 25.' (Article 25 is discussed below.) Again in contrast with material breach, an extended *force majeure* by definition does not arise from the misconduct of the JV party to be expelled. It arises from events beyond that party's control. It is reasonable and typical for the JV parties to want a right to remove a JV party suffering an extended *force majeure* that precludes its performance. After all, the very purpose of the JV is for the JV parties to provide complementary contributions. If one party is precluded from contributing, even if excused as a *force majeure*, the other JV parties still suffer from the excused JV party's inability to perform. There should be a long stop on the excuse. The logical solution is to offer the remaining JV parties an option to buy out the excused and non-performing JV party, as art 17.1(c) effectively does.

The fourth ground for expelling a JV party, in art 17.1(d), is triggered when a JV

party suffers an insolvency event 'which materially restricts [its] capacity to perform its obligations.' This ground is more akin to a material breach, ascribing fault to the insolvent JV party. Though the model JVA does not, it is not uncommon to see a notice and opportunity to cure, and possibly some level of volition or finality in any proceeding or order, before an insolvency event triggers adverse consequences for the allegedly insolvent party.

If a ground for expulsion arises, then art 17.2 empowers the JVCo board or any JV party to initiate the expulsion process by notifying the subject JV party and inviting it to 'present . . . the reasons it may have to object'. The model JVA requires this defence to be presented 'within a reasonable period' or, optionally, by a fixed deadline. The JVCo board and other JV parties only have three months after the cause for expulsion becomes known to initiate the process. This short window may be adequate when the cause for expulsion is a distinct event such as a change in control or a *force majeure* that has outlived its grace period. However, in case of a material breach, and possibly certain insolvency events, the subject JV party's actions and inactions may comprise a sequence of breaches or failures to cure breaches, so that the date from which the three-month period runs is unclear. Imposing such a short timeline on the non-defaulting parties before they must exercise or lose their expulsion rights may also motivate them to have a hair trigger on an extreme remedy that should only be exercised as a last resort. The author thus suggests a more relaxed time for initiating the expulsion remedy. For example, for material breach, one could allow the remedy to be initiated at any time that the breach is continuing regardless of when it first occurred.

After the JVCo board or a JV party initiates the expulsion process, art 17.3 requires the board or any JV party to call a shareholders meeting at the end of the period under art 17.2 for the subject JV party to present its defences. In keeping with principles of due process, the subject JV party is entitled, under art 17.3, to attend that meeting and present its position, but not

to vote. As noted, the decision to expel a JV party requires unanimous approval by the other JV parties. This is a high threshold and may be appropriate in many circumstances. In other circumstances, however, it may be appropriate to reduce the required vote to less than unanimity.

Under art 17.4, the expulsion of a JV party takes effect at the close of the shareholders meeting at which the decision is made. The expelled JV party is immediately excluded from further participation in the JVCo's governance. Article 17.4(a) strips the excluded JV party of its right to attend and vote at shareholders meetings. Under art 17.4(b), any directors nominated by the excluded JV party are automatically removed and lose their right to attend and vote at board meetings. Finally, under art 17.4(c), the votes of the excluded JV party and its directors are no longer required for any JVA unanimity and supermajority requirements.

The remaining JV parties must also purchase the excluded JV party's JVCo shares, but only after completion of a valuation process. In the interim, the excluded JV party has ownership without representation. Such complete disenfranchisement may not be enforceable in some jurisdictions, nor is it necessarily appropriate. On one hand, until the

an expelled JV party one day. This could be due to circumstances beyond its control or fault, such as an extended *force majeure*, and total exclusion from participation in JVCo governance seems a draconian approach. Potential solutions include closing the gap between disenfranchisement and buy-out of JVCo shares, by delaying the former and accelerating the later. Other solutions involve limiting the matters on which the expelled JV party may vote to fundamental decisions, such as a sale of the entire JVCo, rather than day-to-day business decisions.

Article 17.5 provides that in any arbitration of a dispute under art 31 (a topic discussed in a future instalment), the tribunal may award compensation to the expelled JV party if the expulsion was 'wrongful' but may not reverse expulsion. As alternatives, art 17.5 allows the tribunal to order re-admission of the expelled JV party. Another option is to omit art 17.5 entirely. The pros and cons of each approach are beyond the scope of this series due to space limitations.

Article 17.6 provides for the JV to continue between the remaining JV parties after expulsion of one JV party in a manner to be determined at a shareholders meeting. This provision recognises that the expulsion of any JV party other than a pure financial

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remaining JV parties buy its JVCo shares, the excluded JV party remains a shareholder of the JVCo with a legitimate interest in protecting its investment in the JVCo through participation in JVCo governance. On the other, the remaining JV parties will not want the expelled JV party, which is on its way out, possibly due to wrongful conduct, to have any further say in the JVCo's governance. The model JVA tilts toward the latter sentiment.

However, when the JVA is negotiated, each JV party must recognise that it may be

investor may have significant strategic implications for the JV, and may require a replacement JV party or parties to fill the hole left by the expelled JV parties. In extreme circumstances, such as where the excluded JV party was critical to obtaining the licence, concession or contract forming the basis for the JV, the remaining JV parties may be forced to wind up the JV if they cannot identify and recruit a suitable replacement.

When a JV party is expelled, the remaining JV parties must under art 17.7

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Biog box

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acquire the expelled JV party's JVCo shares 'at their Fair Price as established by an Independent Expert.' Article 17.7 specifies that the Independent Expert must value the shares based on the market value of the JVCo as a whole or, if there is no market value, which is likely, at 'a 'fair' price of the Joint Venture Company as a whole (taking into account the effect of the excluded Party's breach and exclusion from the Joint Venture).' The valuation is also required to be made 'without any premium or discount for the size of holding represented by the Shares of the excluded Party.'

Article 17.7 also requires that the buyout be completed within a specified period, which the model JVA leaves to be filled in, after agreement on the price or its determination by the expert. The

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timing of the buy-out raises two practical considerations. First, the expelled JV party and the remaining JV parties are likely to face significant disagreement over the buy-out price. The introduction of an independent expert, while intended to add arm's length objectivity to the determination, may not help as much as hoped.

Article 37.1 refers to the parties jointly choosing the expert, but, if they cannot agree, to following the rules of the ICC's international Centre for Expertise. However, art 17.4 expressly disenfranchises the excluded JV party from participation in all shareholder decisions and does not make exception for appointment of an expert. This should be clarified in the JVA. Typically, in a valuation process, each side can appoint an expert and the value is the average or, if the values differ by more than a certain percentage, a third expert can be appointed by the first two experts or some other mechanism can be used to arrive at a number.

Finally, under art 17.8, all rights that the JVCo and JV parties may otherwise have against the expelled JV party, including those arising from the conduct that may have formed the grounds for the expulsion, are reserved, meaning that the JVCo and remaining JV parties may have causes of action for damages in addition to expelling the other JV party.

Article 24 expressly contemplates that any JV party may raise the topic of reviewing the 'structure and objectives' of the JV based on changed business circumstances and other factors 'which cause hardship to a Party by fundamentally affecting the equilibrium' of the JVA. Each JV party is required 'in good faith to consider any proposals seriously put forward by another Party in the interests of the relationship

between the Parties and/or the business of the Joint Venture Company.' However, no party is required to agree to any amendments to the JVA. As an optional alternative, the model JVA also allows a disagreement on a requested revision to be submitted to an arbitral tribunal, which can order any amendment that 'it finds just and equitable in the circumstances.' This clause of the JVA provides each JV party with moral authority to request that the JVA be amended. It also provides, under some circumstances, a possible defence to an action to exclude a JV party or for other claims of breach if the remaining JV parties do not accept a proposed amendment.

Article 25 provides relief from performance and liability for *force majeure*. Article 25.1 sets out the general principle of excuse for 'non-performance . . . due to an impediment beyond [a JV party's] control and that it could not reasonably be expected to have taken into account at the time of signing [the JVA] or to have overcome it or its consequences.' There is no listing of

specific examples of events of *force majeure*, although art 25.2 lists certain events that will not be considered *force majeure*. In the author's experience, in drafting the JVA, the lawyers should attempt to enumerate as many examples as possible. These serve two purposes. First, in some jurisdictions, the enforceability of a *force majeure* provision may be narrowly construed such that any event not expressly listed may not be a valid excuse. Second, the process of going through the list of examples during negotiations will help the JV parties identify, by express agreement, those specific events that they intend to excuse and those that they do not.

Article 25.3 provides that the excuse will run from the time the *force majeure* event occurs for as long as is reasonable if the event 'is only temporary.' As is typical, art 25.4 requires the JV party claiming the excuse to notify the other parties of the circumstances and their impact on its ability to perform. Article 25.5 requires all JV parties, not just the JV party claiming the excuse, to make 'all reasonable efforts' to overcome the obstacles to the JV's activities that result from the *force majeure*. Finally, art 25.6 provides for expulsion of the affected JV party and acquisition of its JVCo shares by the other JV parties if the *force majeure* continues for more than some specified period of time.

The provisions of art 17 allowing expulsion of a JV party, and buyout of its JVCo shares, for certain causes, coupled with the hardship and review and *force majeure* provisions set out in arts 24 and 25, address some difficult potential future scenarios that go to the root of the purposes for which the JV was formed and provide for possible reconfiguring of the JV to overcome those circumstances. If the initial JV succeeds, these provisions may never be used, but, in those circumstances in which they come into play, they are extremely important to all the JV parties. They therefore merit significant attention and care in drafting and negotiating the JVA. ■

1 The model JVA discussed may be found at www.jurisint.org/doc/orig/con/en/2005/2005jiconen1/2005jiconen1.pdf.