COMMERCIAL WORKSHOP

Business prenup

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By **Jonathan Silverman**

When advising clients on new joint ventures it is crucial to explain how beneficial it is to agree termination provisions at the outset when everybody's on good terms than when tempers start to fray, says Jonathan Silverman

Faced with the client about to embark on a new joint venture blissfully believing their new business partner is fantastic – just like the savvy wealthy couple about to marry, it's prudent for the client to enter into a commercial prenup to safeguard their interests in case the business relationship founders at sometime in the future.

Termination can be effected in several ways when a dispute has arisen and it is worth discussing how to address the issue - the documentation need not be complex. A buyout is the first obvious option, seeing one party agreeing to buy out the other at some time in the future. The joint venturers should establish a mutually acceptable policy on transferability of shares.

While most private company articles contain pre-emption provision, do not take it for granted. If they are not in the articles, ensure the shareholders agreement restricts free transferability. Either forbid the transfer indefinitely, or prohibit it for a stated period and subject to board approval. Transferability of shares is not prohibited as such, the other shareholders are given a pre-emption right: the right of first refusal to buy. Permit only the disposal of the party's entire shareholding to avoid fragmentation.

Other aspects need to be covered off such as confidentiality, restrictive covenants and dealing with assets generated by the joint-venture such as inteelectual property.

It is equally important to think about how the shares should be priced, whether on an assets valuation or profits ratio. Try and agree who will mediate if the parties fail to agree on a price.

Deadlock and termination

The disastrous situation is where the principals' views suddenly diverge, which freezes the activities of the company and puts everything into free fall. Deadlock can arise either in a 50-50 joint venture when the directors take opposing views, when a director emphasises the right to veto, or at shareholder level in relation to matters which require shareholder approval.

Trying to sort out the situation without some sort of mechanism having been put in place at the inception is likely to lead to yet further problems as positions polarise. Discuss with the client the various ways in which a deadlock situation can be dealt with and avoided. These include:

- **The chairman's casting vote:** although this may unlock the deadlock, it gives one party the advantage, which effectively negates the concept of joint control.
- **Appoint an arbitrator or expert:** the appointment of an independent third party to assist in resolving the dispute, someone whom they both respect, who understands the business and can act as an honest broker.
- **Reference to shareholders.** However, while this may often appear the most practical method for an unresolved deadlock at board level, it may open up a further set of problems.

When the deadlock is irresolvable, something needs to be done quickly, otherwise the value of the business can spiral down out of control with the result that there's nothing to divide. Consider the following options:

- **Transfer of shares:** deadlock should serve as a trigger to a buyout as indicated above.
- **Russian roulette:** either party can serve notice to value the other's shares or sell its own to the other party at a specified price. The other party can either accept the offer or reverse it at the same price. The risk of reversal acts as a useful incentive to the offering party to put forward a fair price rather than a silly proposal which is more likely to upset the parties than achieve anything useful.
- **Texas shootout.** This occurs when the party who is seeking to offer to sell its shares decides that it would like to buy out the other party instead, then both parties can submit sealed bids, with a higher winning. While the 'losing party' may at first be resentful, it is worth pointing out that receiving some cash for one's shares is preferable to long-term litigation!

Voluntary liquidation

This is the last resort with no one winning. This court-based procedure results in the assets of the company being realised and distributed to creditors in an order provided for under the law. Any surplus will in theory be returned to the shareholder in proportion to their shareholding, but in reality it is far more likely nothing will be left at the end of the day.

Liquidation is unattractive because it involves the disposal of the company assets shares at a knockdown price combined with potential liability for corporation tax or capital gains tax.

Provisions dealing with termination of joint-venture agreements therefore provide clients with the comfort of knowing that there is from the outset an agreed mechanism as to how to terminate the agreement, which will inevitably save stress, time and legal costs.

Postscript:

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