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ANALYSIS OF SHAREHOLDERS' DISPUTES IN INDIA FROM A FOREGIN INVESTOR'S PERSPECTIVE

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Investing in India can be challenging in view of the myriad of laws at both the Central and State level, as well as cumbersome sector specific requirements. Many-a-times, foreign investors tie up with Indian promoters to overcome these hurdles. However, difficulties get amplified when they get embroiled in litigation / arbitration with Indian promoters over issues related to mismanagement, control, earn-out payments etc.

The disputes which generally arise between the shareholders can be broadly classified into three categories viz., contractual disputes arising out of shareholders/ joint venture agreements, oppression and mismanagement issues and criminal matters.

Contractual disputes: In practice, arbitration is the most popular dispute resolution mechanism for resolution of issues arising under shareholders' agreements. The contractual rights of investors are best protected when highly qualified arbitrators, preferably of a neutral nationality, conduct international commercial arbitrations in accordance with time-bound arbitration rules.

Choice of seat of arbitration also play a key role. For avoiding difficulties in enforcement of foreign awards in India, it is advisable to choose a country which has a reciprocity arrangement with India i.e., territories notified by the Government of India as having reciprocal provisions for enforcement of Indian awards. In the absence of such reciprocity, enforceability of the foreign arbitral awards could potentially take longer. Foreign awards passed in arbitrations seated in territories having a reciprocity arrangement can be put to execution in India straightaway. However, the process for executing awards passed in arbitrations seated in non-reciprocating territories is cumbersome and expensive as the award holder is required to file a fresh civil action in India based on the award and obtain an Indian decree for execution.

In our experience, some of the most hard-fought contractual disputes between shareholders are in relation to earn-out payment. Earn-out is a contractual provision for the seller to receive further compensation if certain criteria (generally financial) are met at a future point in time. It is commonly used in transactions where there is a gap in perceived value of a company between a buyer and a seller. The earn-out allows the transaction to take place and bridges the gap between the parties' expectations of the value of the company, allowing the buyer to only pay for a successful business. To avoid disputes on the valuation of an earn-out, the contractual terms must be as clearly defined and unambiguous as possible. Therefore, it is important for the buyer and seller to mutually agree on a business plan and the level of input which the seller will maintain following the investment / acquisition. This input can include protections and vetoes regarding the management of the business going forward.

Oppression and mismanagement issues: Such disputes generally relate to exercise of undue control, denial of access to company information, oppressive conduct, etc. Over the years, we have seen several instances of Indian promoters continuing to exercise control and direct the policies of joint venture companies despite divesting majority stake. Foreign investors are prone to such risks given their inclination to have expats in senior management roles, at least in the nascent stages of the joint venture investment. Their lack of familiarity with Indian laws gives Indian promoters the opportunity to remain in the driving seat. More often than not, such conflicting controlling interests spiral into serious disputes over time.

These matters constitute violation of the (Indian) Companies Act, 2013 and must be agitated before the National Company Law Tribunal having jurisdiction in the matter. However, care must be taken to segregate the contractual issues and the petition filed must not be a '*dressed-up petition*' for adjudication of matters that ought to be determined by an arbitral tribunal.

Criminal matters: We have seen an increasing trend of criminal proceedings being instituted against expats deputed to Indian joint venture companies as a strategic tool to arm-twist the foreign investor. Therefore, it may be worthwhile for foreign investors to conduct a thorough due diligence of not only the target company but also the background and reputation of the prospective Indian JV partner(s). Also, to handle the practical challenges and mitigate day-to-day compliance risks, foreign investors (who commonly depute expats for key management positions) should consider recruiting new and reliable Key Managerial Personnel (Company Secretary, CFO etc.) locally in India to support them for efficient handling of the operations of the joint venture company.

With the right advise, risks of foreign investors can be mitigated, and a strategy devised for efficiently handling (or possibly even avoiding) shareholders disputes.