Deadlock and Termination: Canada: International Joint Ventures

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1. In the absence of specific provisions in a company's bye-laws or a shareholders' agreement, are any remedies available at law in the event of an unresolved dispute between shareholders resulting in deadlock?

There are several remedies available under Canadian federal and provincial business corporations statutes in the event of an unresolved dispute between shareholders resulting in deadlock.

A shareholder can apply to the court for an order liquidating and dissolving the company. Such an order may be issued where the court is satisfied that:

- The affairs of the company have been conducted in an oppressive or unfairly prejudicial manner or in a way that unfairly disregards the interests of any shareholder.
- It is just and equitable that the company be liquidated and dissolved.

Alternatively, the shareholders can vote to have the company voluntarily liquidated and dissolved. Such a vote would require approval by special resolution (at least 66 2/3% of the votes cast by the shareholders entitled to vote on the resolution).

2. Is it common practice expressly to provide for a dispute resolution process in a joint venture company for an unresolved dispute between shareholders resulting in deadlock? If so, are any procedures commonly adopted? In which document would the relevant provisions commonly be drafted?

Yes. Joint ventures in Canada often provide for some form of dispute resolution process in the event of a deadlock. These provisions could provide for resolution by an expert, such as an accountant, or by an arbitrator or panel of arbitrators. Such provisions are typically found in the agreement governing the joint venture.

One other dispute resolution process that could be used is a "shotgun buy-sell" provision. If there is an irreconcilable dispute, one party can offer to buy the other's interest and the other party can either accept the offer and sell or, alternatively, purchase the offeror's interest on the same terms as the initial offer made to it.

3. Is it common to provide for the compulsory transfer of shares in a joint venture company in any of the following circumstances? In which document are the relevant provisions likely to be drafted and are they likely to be enforceable?

- **(a) Insolvency of shareholder.**
- **(b) Change of control of shareholder.**
- **(c) Material breach of the shareholders' agreement or bye-laws.**

(a) Yes, joint ventures in Canada commonly include a provision in their governing agreement providing for the right of non-affected shareholders to purchase shares of the affected shareholder. Where the provision provides for payment at a price of less than fair value, there is considerable risk it may not be enforceable in an insolvency.

(b) Yes, joint ventures in Canada commonly include a provision in their governing agreement providing for the right of non-affected shareholders to purchase shares of the affected shareholder. Where the provision provides for payment of a price of less than fair value, there is a risk it may not be enforceable on the basis it constitutes a penalty.

(c) Some joint ventures in Canada include a provision in their governing agreement providing for the right of non-affected shareholders to purchase shares of the affected shareholder. Where the provision provides for payment of a price of less than fair value, there is a risk it may not be enforceable on the basis it constitutes a penalty.

4. Is it common in a joint venture company to impose restrictions on the transfer of shares? If so, what sort of restrictions are commonly imposed and in which document are they likely to be drafted?

Yes. Joint ventures in Canada commonly impose restrictions on the transfer of shares. Such restrictions are typically included in the agreement governing the joint venture.

The restrictions on transfer are typically subject to conditions, including:

- Permitted transfers to a related entity (such as a subsidiary) or a tax-planning vehicle (such as a trust).

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- A "right of first refusal", which requires a selling shareholder to offer its interest to remaining shareholders before selling its interest to a third party.
- A "piggy-back right", which provides that if one shareholder sells its interest to a third party, the remaining shareholders are entitled to sell their shares to the third party on the same terms and conditions.
- A "drag-along right", which provides that one shareholder (usually the majority shareholder) can require the other shareholders to sell their shares to a third party on the same terms and conditions as the shareholder exercising the drag-along right.

5. If shares are transferred to a third party in breach of restrictions on transfer (in a shareholders' agreement or bye-laws) what remedies are available to the remaining party?

An agreement governing a joint venture often provides that the company will not recognise or record any transfer that violates the agreement and that the holder of the shares will not be entitled to exercise its rights as a shareholder, such as the right to vote or to receive dividends.

An agreement governing a joint venture also commonly contains default provisions regarding the consequences for a breach of the agreement. If a shareholder has transferred its interest to a third party in breach of the transfer restrictions, the remaining shareholders have a cause of action for damages against the selling shareholder or, if the transfer has not yet occurred, the remaining shareholder could apply for an injunction. If the third party had prior notice of the restriction, the remaining shareholders may also be able to seek an order from the court requiring the third party to transfer the shares back so the remaining shareholders can purchase the defaulting shareholder's interest.

6. Is it possible to provide that in the event of a joint venture company being wound-up, certain assets (such as intellectual property rights) will be transferred to a specific shareholder? Will such a provision be enforceable in the winding-up?

Where an agreement governing a joint venture provides for certain assets to be transferred to a specific shareholder, this type of provision is enforceable in a situation where the shareholders voluntarily agree to terminate the joint venture. However, where a joint venture is being liquidated and dissolved for reasons of insolvency, such a provision is difficult to enforce given that creditors will have a first right over the assets of the joint venture.

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