Family Businesses and Joint Ventures – Cardinal Protections for Minority Shareholders

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Some of the largest businesses in the region, including in Bahrain, are operated through private companies established by family members throughout at least one generation, more often spanning several generations. With family businesses being the economic backbone of the Middle East and North Africa (MENA) economy, it is important to understand the mechanisms to expand such businesses – a joint venture ("**JV**") being one.

Many family businesses are reluctant to enter into JVs with third parties, due to a number of factors, including the potential loss of control and ownership of the business, the distribution of power, and the fear of inadequate protections. Furthermore, family businesses are typically reluctant to divulge certain sensitive information regarding their business to third parties. However, JV's often provide family businesses with: the ability to bid for projects with more weight and expertise, greater resources, access to other established global markets, and are generally more cost effective particularly when a JV partner provides a distribution network as part of the agreement.

Prior to the establishment of a JV, the parties involved need to determine what they each require from the business relationship. Options include but are not limited to:

1. agreements to use a larger company's distribution network;
2. exclusivity to use a supplier's patented and trademarked products and services;
3. having a separate JV to handle a particular project/contract; and
4. creating a long term business partnership, with the possibility of a future merger.

Any of these options require a family business to consider its risk appetite and the potential consequences of a JV fall-out. In the majority of cases, a family business entering a JV will enter as a minority shareholder due to the balance of bargaining power in favour of the larger company. Accordingly, it is crucial for family businesses to safeguard themselves using the appropriate contractual and other legal tools.

These tools include amongst others, the:

1. constitutional documents of the JV; and
2. JV agreement.

The fundamental differences between the constitutional documents and the JV agreement, is that the constitutional documents set out the rights of the shareholders in their capacity as shareholders in the JV, and the JV agreement sets out the detailed terms of the agreement between the shareholders themselves.

Specific commercial details which are not directly associated with the governance of the JV, such as access rights, exclusivity, non-compete, confidentiality, termination and exit clauses are often included in a JV agreement; whereas quorums, board representation and liquidation terms are included in the constitutional documents. Either way, the terms of all the related JV documents should be consistent with each other.

Whilst directors of a JV are not directly bound by the JV agreement itself, they are liable under Bahrain Law No. 21 of 2001, the Commercial Companies Law (the "**CCL**") for a breach of the terms of the constitutional documents and any damages affecting the company, the shareholders and third parties relating to such breach. Article 18 of the CCL provides that a founder, shareholder, manager and director of a company shall be liable for any damages that may be sustained by the company, shareholders or third parties, amongst others, where they violate the provisions of the CCL and the company's memorandum of association or bylaws. Due to the protections provided under Article 18 of the CCL above, family businesses seeking damages for any breach of the rights within the constitutional documents of a JV by a majority third party shareholder, will find that it is a comparatively straightforward process than seeking damages or equitable remedies for a breach of a JV agreement. The CCL institutes an automatic legal right in relation to the breach of constitutional documents, whereas the legal right of a breach of a JV agreement will need to be established and is subject to the discretion of Bahrain or governing law jurisdiction's court. Lastly, any new incoming shareholders are only bound by the terms of the JV agreement if they enter into a new agreement expressly stating that they will be bound by the same rights and obligations set out in it. Constitutional documents, on the other hand, automatically bind all shareholders, and therefore mitigate the risk of an incoming shareholder not being bound by the essence of the JV agreement.

The CCL provides for rights and protections to minority shareholders (in this case a family business). Each shareholder shall have proportional rights and obligations based on their shareholding, non-exhaustively:

- to collect the profit resolved to be distributed to the shareholders;
- to participate in the management of the affairs of the company, whether at the meetings of the general assembly or the board of directors, in accordance with the Memorandum of Association (the "**MOA**") of the company;
- to file an invalidity, claim against any resolution issued by the general assembly or the board of directors in contravention of the Law, the public order and the MOA;
- to dispose of its shares and to have the pre-emption right to subscribe to any new shares in accordance with the provisions of law; and
- the right to inspect the records of the company and to obtain copies or extracts thereof in accordance with the terms and conditions of the MOA.

In addition to the above legal rights, several crucial elements in favour of the minority shareholder that must be contained within the constitutional documents and the JV agreement, include but are not limited to the minority shareholders right to:

1. Board representation;
2. be counted in the quorum of General Meetings;
3. block major decisions;
4. be protected against dilution;
5. an appropriate distribution of profits; and
6. exit the JV.

It is important to note that a minority shareholding of less than twenty-six percent (26%) may hinder the minority shareholder's right to block major decisions. Such major decisions include an assignment of shares free of charge; an amendment to the MOA; a disposal of more than half the JV's assets and a capital increase or decrease. The CCL provides that the approval of such decisions may be implemented legally by shareholders owning at least seventy-five percent (75%) of the capital. Accordingly, this must be taken into account during the negotiation process prior to the establishment of the JV. Alternatively, family businesses who have a stronger bargaining power may enter a JV as a majority or equal shareholder in order to mitigate the risks associated with being a minority shareholder mentioned above. This is typically the route taken by large family businesses who enter into a JV with a multinational company requiring access to the local market to undertake a specific contract or project.

To conclude, family businesses may use JVs to strengthen long-term relationships or to collaborate on short-term projects. Partnering with other businesses may be complex and it takes time and effort to build the correct relationship for the business. In order to reap the benefits of a JV relationship, family businesses must understand the rights and protections required in order to safeguard their position in such arrangements. Accordingly, utmost care must be taken by family businesses in the negotiating stage of a JV, in order to do so.

Al Tamimi & Company's Corporate Commercial and Corporate Structuring team regularly advises on Family Business Structuring and Joint Ventures. For further information please contact Foutoun Hajjar (F.Hajjar@tamimi.com) or Rad El Treki (R.ElTreki@tamimi.com) or Layla Alalawi (L.Alalawi@tamimi.com).