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Advising the Board on **Joint Venture Governance Risk**

Risk, Resilience and Reputation

Directors’ risk

In a joint venture setting, there is often a range of contractual arrangements between the joint venture company and its shareholders, which may give rise to potential and actual conflicts of interests, especially where the joint venture company suffers financial distress and/or insolvency. Proper governance is therefore a crucial aspect of managing such companies, where directors are typically nominated by the shareholders. Directors in joint venture companies should note that they may face additional risks in their position, which may be amplified particularly where the company finds itself in financial difficulty.

Generally, the directors of a joint venture company owe their fiduciary duties to that joint venture company and not to the shareholder that appointed them. The interests of shareholders (and group companies affiliated with the joint venture company) may not necessarily coincide with those of the joint venture company. It is important for directors to be aware of their duties and for any conflicts of interest to be properly managed.

The number of insolvencies in Singapore is expected to increase in this unprecedented global economic downturn brought about by the COVID-19 pandemic. It is important that directors of joint venture companies, who are under the same obligations as directors of other types of company, are aware of their additional duties, as well as the additional personal risks, should their joint venture company experience financial difficulties.

Consequences

Directors

— Risk of personal liability for breach of duty under the Companies Act (Cap. 50), which may result in criminal and/or civil liabilities; companies may also seek equitable remedies against errant directors.

Board/company

— Risk of decision-making process being blocked, leading to significant risk and cost impacts.

Shareholders

— Reputational risk associated with board failures; loss of value.

— Risks of shadow directorship, if the (majority of the) directors are “accustomed to act” under the directions of the shareholders of the joint venture company, such shareholders may be held accountable for any wrongdoing.

Selected directors' duties in a joint venture context

The duty to promote the success of the company

Directors of a Singapore company have a duty to act honestly and in the best interests of the company. This includes a duty to have regard to the need to act fairly as between shareholders in the company. This duty is owed to the company on whose board the directors serve, which in a joint venture context is the joint venture company and not the shareholder that appointed the individual to the joint venture company's board.

For so long as a joint venture company is operating successfully, it is likely that the interests of its shareholders will broadly coincide with those of the joint venture company.

However, when the joint venture company's business is stressed, there may be tension or a divergence of interests between stakeholders. The director's primary duty will be to promote the success of the joint venture company. A failure to discharge this duty will expose the director to the risk of claim for breach of duty, and to liability for that breach. Note that there may well be explicit and implicit pressures applied by a shareholder to seek to influence the decisions taken by its nominated director at the joint venture company's board.

Depending on the extent to which the joint venture company is underperforming (financially), the focus of a director's duties may shift from the shareholders to the creditors of the joint venture company. In broad terms, the greater the risk of insolvency, the more likely it is that creditors' interests take precedence over the interests of shareholders. This can be particularly challenging in circumstances where there is no shareholder value remaining or a director is under pressure to commit less time to the joint venture company.

Understanding the statutory solvency test is important and directors should take advice promptly where a joint venture company is in potential financial difficulties or it is clear that the company will become unable to pay its debts as they fall due at a future date.

The duty to make proper disclosures

Directors generally have a statutory duty to disclose any transaction or proposed transaction with the company in which he is directly or indirectly interested. Such disclosures should be made to the Board and the company as soon as is practicable after the relevant facts have come to such director's knowledge There are often contractual arrangements between a joint venture company and its shareholders or group entities or affiliates. In many cases these may be matters in which a shareholder's nominated director has an indirect interest, not least as a consequence of being employed by the shareholder (or a related group company). These arrangements are matters which will need to be formally disclosed.

The joint venture company should maintain an accurate and current record of declarations of interests and each director should regularly review and where necessary update relevant declarations. It is also good practice for the need to make further declarations of interest to be considered at each board meeting.

The duty to avoid conflicts of interest

The duty to avoid conflicts of interest ties in with the duty to make proper disclosure. Directors have to avoid a situation in which they have, or can have, a direct or indirect interest that conflicts, or may conflict, with the interests of the company.

This duty is not infringed where either the interest cannot reasonably be regarded as likely to give rise to a conflict of interest or (and of more relevance here) where the matter has been properly disclosed and, if required, that the relevant directors abstain themselves in the decision making of such matters.

The constitutions of joint venture companies would also typically contain provisions for dealing with directors' conflicts of interest.

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Additional considerations in the event of financial distress

Outside of the usual directors' duties outlined above, if the joint venture company suffers financial difficulties, there are additional considerations for directors. Where the joint venture company is insolvent or is nearing insolvency, its directors have a fiduciary duty to take into account the interests of the company's creditors, and to ensure that the company's assets are not dissipated for their own benefit to the detriment of creditors' interests.

Management and resignation

As a general principle, directors can resign at will (subject to the Companies Act requirement that a Singapore company shall have at least one director who is ordinarily resident in Singapore). However, where a company is in financial difficulties, a director's principal duties are owed to creditors and he/she should not just resign if doing so would adversely impact on the management of the company or the position of the creditors. The exception to this principle is where a director is unable to influence the board to act in the interests of creditors. Note that the resignation by a director does not, on its own, absolve him/her from liability for any breaches of duties.

Interests of creditors

Where funders have rights on default, funders may ask for additional persons to join the board and the existing board members must carefully consider the interests of all creditors, including authorities, in relation to those requests.

Fraudulent trading and continuing to trade when there is little prospect of being able to pay when due

There is a risk of personal liability for directors if, in the course of the winding up of a company or in any proceedings against a company, such directors were knowingly a party to the carrying on of any business of the joint venture with intent to defraud creditors. Directors can also be liable for contracting a debt knowing that there was no reasonable prospect or probable grounds of expectation that the company would be able to pay the debt.

Reviewable transactions

Directors may be found to be in breach of their fiduciary duties to protect the interests of creditors, and can also become personally liable should they cause the joint venture company to enter into transactions during the period leading up to formal insolvency which constitute transactions at an undervalue or where an unfair preference is given to specific creditors. In such circumstances, a liquidator may seek a court order that the preferred creditors return the sums for proper distribution to all the company's creditors under insolvency legislation.

Disqualification / Prosecution

A breach of director duties may attract criminal and/or civil liabilities. Companies can also seek equitable remedies against errant directors who breach their fiduciary duties. If it appears to the Court (in the course of a court winding up) or the liquidator (in the course of a voluntary winding up), that any past or present director of the company has been guilty of an offence in relation to the company for which he is criminally liable, the Court may, either on the application of any person interested in the winding up or of its own motion, direct the liquidator to prosecute the offender. The director may be prosecuted and be disqualified from acting as a director in the future.

Managing directors' conflicts

It is inevitable that conflicts will arise in relation to a joint venture company – and crucial for its directors to be alive to the risk of conflicts and to be fully aware of both their statutory duties in this regard and of how conflicts are addressed in the constitution of the company, and in any shareholders' / joint venture agreement.

The way these conflicts are to be addressed needs to properly managed, via:

— Appropriate provisions in shareholders' / joint venture agreements and constitutions

— Proper oversight and controls exercised by non-conflicted directors on boards together with a practice of proper disclosures

— In certain circumstances, establishing sub-committees of the board or board protocols to manage circumstances of conflict: this can be particularly difficult in joint venture companies where unanimity is often required for board actions under the constitutional documents

Disputes and dispute committees

We have seen an increasing use of board committees to consider and manage the conduct of disputes with shareholder group members, and the drafting of the terms of reference for such committees is important.

Key issues include:

— The membership of the committee (and how this fits in with shareholders agreement requirements)

— The extent of the committee's role

— Access to external advice, and the budget for this

— The extent of reports to the full board (and what information might be retained or redacted) – in some cases this may be by way of high level summaries of the committee's business

— How legal professional privilege is preserved

— Any need for a waiver of shareholder's general rights to information.

Managing confidentiality issues

A director, while in office, has the right to be informed about the company's affairs and to inspect all the company's books and records. This right must be exercised for a proper purpose, to enable the director to discharge his/her personal obligations to the company and his/her statutory obligations.

Each director owes a duty of confidentiality to the joint venture company. Where the director is appointed by a shareholder, he or she must not, without the authority of the company, disclose to that shareholder any confidential information relating to the company which has been gained by him or her as a director of that company.

However, the right to information will also be usually governed by the shareholders' agreement. Shareholder nominated directors will often be specifically authorised to disclose confidential information to the shareholder that appointed them. The shareholder may have an explicit right to require that the joint venture company provides specific categories of information, and sometimes a more general right to request information.

Directors should be aware of these confidentiality provisions and also consider if they are appropriate in all circumstances.

For example:

- It may be appropriate when putting together board packs, and drafting board minutes, to deal with categories of information differently (for example by way of oral presentations on particularly sensitive areas)
- Non-conflicted directors may wish to exclude conflicted directors from parts of meetings and provide redacted board packs if these contain information which is not appropriate to be shared with them
- Board committees may be appropriate to consider particularly sensitive issues

Where listed companies are involved, directors should of course also comply with the rules in relation to disclosure of price sensitive information and other relevant listing regulations. When in doubt, they should always seek professional advice at the earliest opportunity.

Summary: practical risk management

Be aware of duties, and seek specialist advice at the earliest opportunity where unsure.

Keep proper board minutes records of disclosures made, and regularly review and update, conflicts position and policies.

Be familiar with rights and obligations under the constitution and shareholders' / joint venture agreements.

Consider how best to manage shareholder group disputes.

Ensure confidentiality issues are properly addressed.

Hold adequate and regular training / update sessions so that directors are aware of developments in the laws which affect their statutory obligations.

Ensure a separation of board and shareholder decision-making (ideally with different constituent groups).

Ensure all relevant matters are reported to insurers to maintain D&O cover (if applicable).

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