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Resolving Deadlocks in Joint Ventures

Introduction

Bold and timely corporate decisions on key matters by shareholders are critical for a business. When shareholders cannot agree on decisions to be taken, a deadlock arises, which may bring the company's business to a standstill.

The disruption is often detrimental to the company's business. As such, understanding the potential options available to overcome a deadlock is essential in the context of joint ventures.

It is not only companies with an equal split of ownership or a 50:50 joint venture that are susceptible to deadlocks. Companies where shareholders have disproportionate shareholding / board seats usually have, in their shareholders' agreements, reserved matters that require super-majority or unanimous consent at shareholder and/or board levels as a form of minority protection. Any inability to agree on such reserved matters also constitutes a deadlock.

A well-considered shareholders' agreement will incorporate deadlock mechanisms to be employed when the parties reach a deadlock.

A. Continuing the Joint Venture

Shareholders may wish to consider the following deadlock mechanisms to resolve a deadlock amicably without collapsing or exiting from the venture.

Escalation to Senior Management

The deadlock resolution provision may require the deadlock to be referred to the designated senior management of each relevant shareholder. This allows for a consultative resolution through negotiation between the relevant shareholders.

Senior management generally have the authority to make exceptions, weigh trade-offs and propose arrangements that were previously not on the table.

Referral to a mediator or subject matter expert

Such a deadlock resolution provision triggers the involvement of a mediator or subject matter expert when a deadlock arises.

A fresh perspective from a neutral third party may serve to de-escalate the deadlock when the relevant shareholders are entrenched in their positions.

The deadlock shareholders may be more receptive to hearing an un-involved third party setting out their proposed approaches to the matter.

B. Exiting the Joint Venture

If the amicable approaches fail to resolve the deadlock, the following deadlock mechanisms may be employed to resolve a deadlock. These deadlock mechanisms involve the exit of a shareholder through a buyout or a collapse of the venture entirely.

Put and Call Options

A shareholder with a Put Option is entitled to require the other shareholder to buy its shares at a pre-determined or fair market value. Conversely, a shareholder with a Call Option is entitled to require the other shareholder to sell their shares to it at a pre-determined or fair market value.

The Call Option generally benefits the shareholder with stronger financial capabilities as it retains the option to buy out the other shareholder.

The Put Option, on the other hand, is potentially more beneficial to the shareholder with a weaker financial capability as it allows such a shareholder to exit the company at a fair or pre-determined price.

Russian Roulette

Under this fancifully termed deadlock mechanism, a shareholder is entitled to issue a notice to the other shareholder offering to either (i) buy out the other shareholder at a specified price ("offered price") or (ii) requiring the other shareholder to buy it out at the offered price.

The shareholder receiving the notice is then required to either sell its shares at the offered price or buy the other shareholder's shares at the offered price.

This mechanism ensures that a fair price is offered, as the shareholder issuing the notice bears the risk that if its offered price is too low, it will be required to sell its shares to the shareholder receiving the notice at that offered price.

Texas Shoot Out

Yet another fancy termed mechanism, a Texas Shoot Out (or a 'sealed auction') involves each shareholder submitting a sealed offer to an independent third party (which may be the company's auditors or an independent accounting firm pre-determined by the parties) offering to purchase the other shareholder's shares at a stated price in its offer.

The submitted sealed offers are opened simultaneously as facilitated by the independent third party and the shareholder that made the highest offer will have to purchase the other shareholder's shares at the stated price in its offer.

This mechanism favors the shareholder with stronger financial capability and could lead to exits at higher share valuation - especially if the shareholders are in the same bracket of financial strength and do not wish to be 'out-bided' by the other shareholders.

Winding Up

This mechanism should be one of last resort and will result in the collapse of the venture that could otherwise be commercially viable.

In the event that a deadlock cannot be resolved within a specified period of time, the shareholders' agreement would provide the option for a shareholder to apply for the winding up of the company.

Conclusion

The above discussed deadlock resolution mechanisms are but some of a variety of tools available for shareholders to resolve deadlocks in the joint ventures.

Shareholders should, in their shareholders' agreements, consider designing the appropriate workable solutions and deadlock mechanisms tailored to resolve any deadlock when consensus unfortunately breaks down.

For more information, or should you have any queries or require assistance on corporate or shareholder matters, please feel free to contact Aaron Kok at akok@bihlilee.com.sg or Jesh Ho at jho@bihlilee.com.sg.



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