

Business Through Joint Ventures

Review of main features of this business arrangement; a look at how new PRC law relates

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A popular method of transferring technological know-how, particularly from an industrialized country to a developing one, is by means of a joint venture. This is a vast subject, and I can only hope to cover here some of the main commercial and legal features of this kind of business organization and alert you to some of the problems which may be encountered. In view of its international importance, I have specifically illustrated many of the points with examples taken from the provisions of the recently promulgated Law on Foreign Joint Ventures of the People's Republic of China. This new law, although not perfect and requiring complementary legal measures for its practical development, represents the first major step toward establishment of western industrial, technological, and capital projects with the Chinese. To begin, what is a joint venture?

A joint venture is a partnership between two or more persons or enterprises, who join forces in pursuit of a particular common economic objective. It involves sharing profits and risks, and perhaps its most important advantage from a practical point of view is that it may take many different legal forms. For example, the exploration and exploitation in the United Kingdom of the reserves of oil and natural gas in the North Sea is largely being undertaken through joint-venture agreements and arrangements between the international oil companies concerned. These arrangements rest primarily on the laws of contract and agency, and do not depend upon the existence of any legal entity as such. Thus, a high degree of operational flexibility is possible, with resultant commercial benefits.

Flexibility

It has been well said that, if a joint venture is over-regulated, it cannot prosper. However, such flexibility may be achieved at the price of legal certainty, unless the basic contractual rights and obligations of the joint venturers are clearly defined in a formal agreement, and the proper machinery for managing the venture and settling differences or disputes is agreed, set up,

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and operated by the parties. For large-scale joint ventures, a management committee, composed of individuals representing the different economic and commercial interests involved, is absolutely essential.

Another advantage of joint venture arrangements is that the costs of financing large-scale industrial and engineering projects, for instance, the designing,

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building, and commissioning of nuclear power stations, steel mills, and other manufacturing facilities, can be shared among several parties. Indeed, for such projects, the bringing together of several — but complementary — technological skills, know-how, expertise and industrial processes is an essential ingredient in the success of the project or venture.

LEGAL FORMS

As mentioned, joint ventures may assume several legal forms. The parties may, for example, incorporate a joint-venture company for carrying out the agreed project. They may also form themselves into some kind of legal partnership or other association (whether incorporated or not) recognized by the legal system concerned. In Spain, for example, joint ventures may be formed as an "association of enterprises" ("asociacion de empresas"), with or without legal personality, or by means of what is known as a "contract of joint accounts" ("cuentas en participacion"). And in France, the institution of "Groupement d'Interet Economique" ("GIE") may be used pursuant to the Ordinance of 23rd September, 1967. In the EEC, plans are well advanced for the creation of the European Cooperation Grouping ("ECG"), an adaptation of the French "GIE", for cross-frontier business cooperation.

The kind of joint venture vehicle to be used will depend upon a number of considerations:

1. The nature of the venture itself.
2. The juridical nature of the persons involved.
3. Raw materials requirements.
4. In the case of transnational joint ventures, the legal, exchange control, and tax regulations of the country in which the venture will be pursued.

In the latter case, the political stability or instability of the country concerned will also, of course, be an important factor.

Under the new Foreign Joint Ventures Law of the People's Republic of China, adopted by the National People's Congress on July 1, 1979, and effective as of July 8, foreign companies, enterprises and individuals may now make capital and technological investments in China. But in so doing they must adopt the form of a

joint-venture limited-liability company, contributing at least 25% of the registered capital. By virtue of Article 5 of this law, each party to the joint venture may contribute cash, capital goods, or industrial property rights. The technology or equipment contributed by the foreign participant must be "truly advanced and appropriate to China's needs."

The Chinese participant may contribute, for example, the "right to the use of a site provided for the joint venture during the period of its operation". Whatever contributions are, in fact, made by the participants in the joint venture, they must be "specified in the contracts concerning the joint venture or in its articles of association, and the value of each contribution (excluding that of the site) shall be ascertained by the parties to the venture through joint assessment".

VALUING THE CONTRIBUTIONS

In general, this latter point on the valuation of contributions to joint ventures can give rise to difficulty in practice. Where the participant contributes cash, it is straightforward, but where, however, the participant contributes in kind, e.g. industrial property rights, personal technical services, real or personal property, the evaluation in monetary terms of such contributions may be difficult to determine and agree.

Since the share of profits is usually geared to the relative values of the participants' contributions, this is a crucial point. Likewise in a joint-venture company, the allocation of shares will normally depend upon the proportions in which the shareholders have contributed to the registered share capital. For instance, Article 7 of the China Joint Ventures Law provides as follows:

The net profit of a joint venture shall be distributed between the parties to the venture in proportion to their respective shares in the registered capital after the payment of a joint-venture income tax on its gross profit . . . and after the deductions therefrom as stipulated in the articles of association of the venture for the reserve funds, the bonus and welfare funds for the workers and staff members and the expansion funds of the venture.

Under article 2 (1) (c) of the Spanish Foreign Investment Regulations of October 31, 1974 (as approved by Decree No. 3022/74), for example, foreign investments may be made in the form of "direct contribution to a company of foreign technical assistance, patents and manufacturing licenses" and such forms of investment are subject to valuation by the Customs Authorities in accordance with the General Customs Law.

ESSENTIAL CLAUSES IN JOINT VENTURE AGREEMENTS

It cannot be over-emphasized, therefore, that the respective contributions of the joint venturers must be clearly defined, and their respective values, at the relevant time, agreed and inserted in the corresponding documentation. Other essential matters to be included in the joint-venture agreement will now be summarized, taking as a model a joint venture relating to the design, building and commissioning of a factory.

Perhaps the most important provision is the definition of the project itself, and in particular what each of the parties concerned is required to do.

One party, for example, may be responsible for all the site investigations; another for drawing up the detailed plans; someone else for commissioning or undertaking the works; and so on. All the respective roles in connection with the project need to be clearly defined and responsibilities allocated.

Equally, the terms upon which advisory staff and technical personnel are to be provided by one of the joint venturers, and the bases for charging out these services, also need to be clearly set forth in the agreement. The provision of technical drawings needs to be covered by a suitable clause, in so far as the protection of industrial property rights in those drawings is concerned.

Likewise, disclosure of unpatented know-how, in the course of developing the project, will require an appropriate confidentiality clause. Further, not only should the proportions in which profits are to be shared be agreed and stated, but also specific provision should be made for the sharing of losses. Where certain expenses are to be charged to the joint venture, their nature, commercial justification and reasonableness (including limits) should be provided for in the agreement.

General Clause

A useful and protective general clause to include is one requiring all modifications to the project, the agreed manner of its implementation, or to any of the arrangements, to be the subject of formal written amendments, signed by all the parties, or their legal representatives. Such a clause can often eliminate acrimonious disputes or differences of interpretation at a later date — perhaps at a time when the project has reached a crucial stage.

It is also desirable to make provision for a "steering committee" to be formed, in order to oversee the progress of the project. Any decisions of such a committee should be duly minuted. The need for continual consultation and communication between the joint venturers throughout is most important to the smooth running and the ultimate success of the project.

In view of the fact that any of the parties to a joint venture arrangement have ostensible authority to conclude contracts, on behalf of the joint venture, vis-a-vis third parties, it is advisable to include cross-indemnities in the agreement, which may be invoked in the event of any such party exceeding his powers or committing the joint venture to any unauthorized transactions.

Provision should also be made for the termination of the agreement in certain defined circumstances (e.g. force majeure), and the orderly winding up of the venture (including the settlement of final accounts) on such termination or its natural completion.

In the case of transnational joint ventures, the parties should agree on an authentic language text for the Joint Venture Agreement, and provide for certified translations of this text into other languages as required. Proper law and arbitration clauses should also be included.

As a general drafting point, full use should be made of schedules for setting out such matters as technical specifications and industrial property registration details.

Finally, full regard must be paid to the prescribed formalities applicable in the place of execution of the agreement, not only concerning its essential validity, but also any evidential requirements for its enforceability. In this latter respect, any corresponding stamp duties should be assessed and paid.

GOVERNMENTAL CONTROLS

In the case of international joint ventures involving the incorporation of a joint-venture company, the promoters must comply with any applicable Foreign Investment Regulations, and, in particular, obtain any necessary governmental permits or consents. It should clearly be agreed who is responsible for obtaining them, and time limits for this purpose should generally be stipulated. For example, in many countries throughout the world, foreign equity participation in locally incorporated companies is often restricted. In India, there is a general 40% limit; in Spain, the normal limit is 50%. Practices vary widely in the Middle East States and elsewhere. For example, under the Yugoslavian Foreign Investment Law, which came into force on April 15, 1978, the foreign investor is entitled to participate in a joint venture up to 49%.

28 Joint ventures involving the use of industrial property rights may likewise be subject to a variety of governmental controls, and such arrangements may well be subject to strict screening and approval processes. Such requirements not only affect the contents of joint-venture agreements, they also have a significant effect upon timings and timetables, particularly commissioning and delivery dates. In Eastern Europe, for example, penalty clauses are very common. In Spain there are administrative controls over restrictive clauses and the transfer of royalty payments abroad. Under Article 9 of the new China Joint Ventures Law, it is necessary to file the production and business program of the joint venture with the authorities. Under the provisions of the same article, the joint venturers are required to give "first priority" to Chinese sources of raw and semi-processed materials, fuels, auxiliary equipment, and other requirements.

FINANCIAL ASPECTS

As with any kind of commercial agreement, and especially one which transcends national boundaries, the fiscal and financial implications of joint-venture

arrangements must be carefully considered. For example, to what extent, and, in what circumstances, are expenses of the joint-venture tax deductible? Are payments for services under the joint-venture agreement gross or net, i.e. before or after tax? What taxes do the various payments under the agreement attract? How can such taxes be mitigated? For example, payment arrangements which take full advantage of double-taxation agreements and the intelligent use of any fiscal incentives. Under Article 7 of the new China Joint Ventures Law, a foreign participant who reinvests any part of his share of the net profit within the Chinese territory, may apply for the restitution of the corresponding part of the income taxes paid. Again, the foreign joint venturer should be acquainted with any applicable exchange control requirements and procedures, which may affect the financial returns of the project. With the aid of such information, sensible pricing policies can be made.

As to the currency of repatriation, the China Joint Ventures Law, for example, provides in Article 10 that the funds shall be remitted in the currency or currencies specified in the joint-venture contract.

GENERAL OBSERVATION

As mentioned at the outset, a joint venture, irrespective of the form it may take, is in the nature of a partnership. Success or failure depends upon some of the points or matters which I have mentioned or illustrated, but, perhaps above all, depends also upon the selection of the partners themselves for the actual project and upon their mutual trust and respect. It is prudent, therefore, to select the joint venturers after making the fullest possible financial and commercial inquiries. In this respect, the usual credit reference agencies, research bodies, industrial development organizations, trade associations, and chambers of commerce can be most helpful, not only in the selection process, but also in setting the prospective candidates.

CONCLUSION

With increasing international trade and economic cooperation and integration, the use of joint ventures, of one kind or another in the technological and industrial fields will continue to grow, and also provide lawyers and licensing executives with an exciting and challenging field of practice.