Anatomy of Yugoslav Joint Venture

How a U.S. pharmaceutical company and Yugoslavians worked together for mutual benefit

BY LAWRENCE W. FLYNN*

In the late 1978, the Yugoslavs contacted our Belgian subsidiary, Travenol Laboratories, S.A. ("Travenol") to propose that it form a joint venture with a Yugoslav work organization to produce dialyzers (artificial kidneys). Although Travenol ultimately became the joint-venture participant, I will use in this article the name of Travenol's better-known parent, Baxter Travenol Laboratories, Inc. ("Baxter"), the U.S. health care company headquartered in Deerfield, Illinois.

Baxter was interested in the joint venture, and began an evaluation of the proposal. This resulted in a decision in early 1979 to proceed further with the Yugoslavs.

We obtained a copy of a Yugoslav joint-venture agreement appropriately blanked out. Our review of the agreement showed that it was lengthy, extremely detailed and necessitated a thorough study of the various Yugoslav laws affecting the establishment and operation of a Yugoslav joint venture and the transfer of technology into Yugoslavia.

In July, 1979, Baxter organized a team to negotiate the joint-venture agreement with the Yugoslavs. The team included, in addition to myself, a Baxter European lawyer and an international financial specialist from Deerfield. By way of preparation, we studied the following:

1. U.S. regulations governing the export of technology to Yugoslavia.
2. The Yugoslav Joint-Venture Law.
3. The Yugoslav Medicinals Law.
4. The Yugoslav Long-Term Cooperation Act.

One should begin with the Export Administration Regulations of the U.S. Department of Commerce which set forth controls on the exportation of technical data (15 CFR 379.1 through 379.9 and Supplement Number One to 15 CFR 370). The Commerce Department advised us that we could transfer the technical data to Yugoslavia under General License GTDR.

The Yugoslav Joint-Venture Law governs the establishment, operation and termination of the joint-venture organization; hence it is of utmost importance in drafting the joint-venture agreement.

Provisions

The following are among the more significant provisions of the Joint-Venture Law:

Article 11: Maximum 49% participation by the foreigner.

Article 18: The foreigner's income from the joint venture is his portion of the gross income less several deductions; one should quantify these deductions; Article 18 permits this.

Article 23: The foreigner can repatriate his profits.

Article 25: In lieu of paying the foreigner his profits in cash, they may be paid by delivery of joint-venture products.

Articles 29-30: The foreigner may transfer his rights and obligations under the joint-venture agreement to a third party (Article 29); however, Article 30 requires that the first offer be to the joint venture.

Articles 31-32: Upon termination of the joint venture, the foreigner can repatriate the value of the assets or the assets themselves.

Article 36: The joint venture can reimburse the foreigner for his invested assets by products manufactured by the joint venture; note: not the same as Article 25.

Articles 40-41: The joint-venture agreement must be approved by the Federal Committee on Energy and Industry (the "Federal Committee" or "Committee").

Article 42: Enumerates seven conditions which dispose the Committee toward approval of the joint-venture agreement plus three which dispose it to reject the agreement. The most important of the latter is any clause restricting export of joint-venture products.

The Medicinals Law with its controversial Article 27.5 mandating Yugoslav ownership of the western partner's trademarks did not apply to the Baxter Joint Venture because dialyzers do not fall within the scope of this law. Next comes the Yugoslav Long-Term Cooperation Act, considered by many a major deterrent to doing business in Yugoslavia. The more onerous provisions are in Article 24 of the act although Article 37 also has its share and should be studied carefully. A synopsis of some of the most controversial Article 24 provisions follows:

Article 24(4): The technology supplier must inform the joint venture of all related improvements; 24(4) requires divulgation but does not permit the joint venture to use the improvements free of charge.

Article 24(7): The technology supplier must guarantee that his technology is not harmful to people or the environment.

Article 24(8): The technology supplier is liable for damage arising from the joint venture's use of the technology or from products manufactured by the joint venture provided the joint venture used the technology in accordance with the technology supplier's instructions.

Article 24(10): The joint venture cannot be required

**Group Patent Counsel, Baxter Travenol Laboratories, Inc., Deerfield, IL.*

to keep the transferred technology confidential for more than three years after the joint-venture agreement expires.

There is no preclusion under Yugoslav law against the technology supplier contractually limiting his Article 24 liabilities. Most multinational companies already carry insurance in Yugoslavia which may cover the Article 24 guarantees, or can purchase such insurance.

Baxter's particular situation encouraged us to proceed with the joint venture. First, Baxter had experience of long duration in manufacturing the joint-venture products. Baxter had developed the commercial technology and specialized equipment needed and was aware of the minimal safety risks involved. In addition, we had previously transferred the same technology from Belgium to our other plants and therefore knew firsthand the risks involved in such a transfer. Finally, we had established close contact with the Yugoslavs and recognized the competence and enthusiasm of their management, engineers and work force. We saw little reason to doubt the successful transfer of our technology to the Yugoslavs. A thorough "risk analysis" may well convince the western partner that he has little concern for worry because of the Article 24 guarantees.

Consensus

After completing the analysis of the proposed joint venture, the consensus was that the business opportunities outweighed the Article 24 risks. There were risks, but a transaction as complex as a joint venture in Yugoslavia would never be risk-free. The key point is that the risks imposed by Article 24 of the Long-Term Cooperation Act, if properly evaluated, need not necessarily table the joint venture. Each joint venture is different and there may be ways to negate or at least mollify the extent of the risks so that one need not forego the business opportunity available.

Another important point to understand in joint ventures or other technology transfers in Yugoslavia is that Yugoslavs interpret the term "license" as "assignment". Even though the joint-venture agreement may state that a party is granting a "license" to the joint venture under its patents, know-how or trademarks, the Yugoslav position will be that regardless of the language used, the joint-venture organization eventually takes full title to these assets. No provision in the Long-Term Cooperation Act explicitly states this; however, such a construction is implicit under the provisions of Articles 37 (1), (2), (5) and (8).

One point of clarification is necessary on license versus ownership rights. During the term of the joint venture, the assets are licensed to the joint venture in the same sense we in the U.S. and Europe understand the term "license". It is not until the joint venture terminates that title to the assets vests permanently in the surviving joint-venture organization. The foreign licensor may be able to recapture his licensed assets if, prior to the end of the joint-venture term, he unilaterally terminates the joint venture pursuant to a provision such as the Yugoslav party's breach. While it is admittedly not clear, the Yugoslav joint venture probably should not acquire title to the assets in question under such circumstances. However, a pragmatic technology supplier will assume that once the patent, know-how or trademark rights are conveyed to the joint venture, they are gone forever.

The Yugoslav theory in asserting ownership to such assets upon termination of the joint-venture term is simple; these assets are normally capitalized at the start of the joint venture and credited to the foreign partner as his initial equity contribution; under Article 32 of the Joint-Venture Law, the foreigner's equity contribution is returned upon termination of the joint venture, for example, as a cash payment; since the foreigner has thus been compensated for his patents, know-how and trademarks by the joint venture, the joint venture owns these assets.

This, of course, is the essence of the trademark problem under Article 27.5 of the Medicinals Law. The joint venture upon conclusion of the joint venture, as owner of the mark, can use it however it sees fit. The original trademark owner is justifiably concerned about this because he can no longer exercise quality control over the products on which the Yugoslavs place the mark.

Another problem is that the Yugoslav joint venture may market products bearing the foreigner's mark in the same markets where the foreigner sells its own product under the identical mark. Although such may be unlikely to happen during the term of the joint venture, nothing prevents this once the joint venture is terminated. This can lead to confusion in the marketplace and may destroy the foreign partner's business on such products.

Article 27.5 of the Medicinals Law is not the only provision of Yugoslav law which vests ownership to a trademark in the Yugoslav joint-venture. Certain provisions in the 1979 Joint Venture Law also accomplish this. The safe rule to follow, therefore, is that if you wish to fully protect your trademark, do not license it to the joint venture. This obviously is a problem where the subject matter of the joint venture is a medicine. However, if the joint venture does not come within the scope of the Medicinals Law, there is no requirement that the foreign party license the joint venture under this trademark.

Baxter's first negotiating session was in Belgrade in September, 1979; it was a two-day discussion centered on general business issues; the objective was to reach agreement on the basic principles and scope of the joint venture.

Most of the Yugoslavs spoke only Serbo-Croation. Because of this and the number of people present, it was difficult to conduct discussions without consuming large amounts of time. This situation improved in subsequent meetings as the Yugoslav contingent became smaller, more translators were furnished and the emerging head Yugoslav negotiator spoke fluent French and acceptable English.

The discussions were amicable and business-like until the parties reached the trademark issue. The Yugoslavs told us it was essential to the joint venture that we include our trademarks for the products in question. Their prime interest was in our house mark "Travenol" because Baxter had marketed dialyzers in Yugoslavia under that mark and consequently it was well-known to those at the Yugoslav dialysis centers responsible for making dialyzer purchase decisions.

Although the Yugoslavs wanted our trademarks, they never demanded them under Article 27.5 of the Medicinals Law, or stated that it was a mandatory requirement under Yugoslav law. Their basis was to enhance the marketing strength of the joint venture in Yugoslavia and in the joint venture's secondary markets where the Travenol mark was also well-known. Baxter informed them that we were unwilling to license our trademarks. We would not risk losing quality control with respect to our marks, and we did not want the joint venture competing with us in Western Europe and other markets using Baxter's marks. The Yugoslavs finally agreed that the joint venture would develop its own unique Yugoslav marks.

During the September 1979 meeting we reached agreement on how hard currencies would be infused into the joint venture in order to permit Baxter to repatriate its profits in hard currency and the joint venture to pay for materials purchased from Baxter in hard currency.

The mechanism for this was that the joint venture, in addition to manufacturing dialyzers, would manufacture medical gloves for Baxter. Baxter would buy the gloves, making payment in a hard currency, and then sell the gloves in Western Europe. The quantity and pricing of the gloves was dictated by the amount of hard currency the joint venture would need to repatriate Baxter's profit in hard currency and to pay Baxter for its purchases of materials necessary in the joint-venture production.

Following the September 1979 meeting, Baxter drafted the joint-venture agreements in accordance with U.S. practice. As it later turned out, we encountered no problems because of this; in fact, we believe it reduced the negotiation period; the Yugoslavs never objected to the format of our agreements.

Five agreements were drafted to create the joint venture:

(a) **The Joint-Venture Agreement:** the prime agreement creating the joint-venture organization and setting forth all key aspects of the joint venture, (management, its purposes and objectives, production capacities, the financial aspects including sharing of the income by the partners, equity participation of each partner, and repatriation upon conclusion of the joint venture of Baxter's invested assets).

Baxter's initial contribution was primarily technology which was capitalized and included as a part of Baxter's equity contribution. Zdravlje contributed land and buildings. Baxter's equity participation will rise to 48% by 1985.

Disputes arising from the joint-venture agreement will be settled in Switzerland before Swiss arbitrators applying the law of the Canton of Zurich.

The joint-venture agreement was drafted based on the Yugoslav Joint-Venture Law. This law is clear on most points, and a long and complicated agreement is not required in order to meet its requirements.

(b) **The Technology Transfer Agreement:** the second important agreement; it must comply with the Long-Term Cooperation Act.

It provides for licensing of patents and know-how to the joint venture and for training Yugoslav personnel (1) at Baxter plants where the joint-venture products are manufactured, and (2) on-site in Yugoslavia during construction, startup, and initial operation of the plant.

The agreement specifies that the joint-venture plant must receive final technical certification from Baxter's engineers before commercial production of dialyzers in Yugoslavia can begin.

It is important to limit the technical assistance personnel and time the foreigner will invest in training Yugoslav technicians. One should avoid open-ended commitments to supply manpower to the joint venture. Since the quantity of this manpower was included in Baxter's intitial equity contribution, there was no additional charge to the joint venture for such manpower. However, this made it necessary to limit the technical assistance to an amount commensurate with the value Baxter had taken for it as part of its initial equity contribution. Baxter recognized that additional technical assistance would probably be required and provided for this on a purchase basis.

The technology transfer agreement must contain the clauses and guarantees required by Article 24 of the Long-Term Cooperation Act. It must also avoid the prohibited clauses in Article 37 of the same act. However, Article 37 does grant the Federal Committee discretion to approve agreements which contain one or more of the clauses prohibited under Article 37. For example, in Baxter's technology transfer agreement, there are provisions which impose restrictions on the joint venture's use of the transferred Baxter technology, and, therefore, seemingly violate Articles 37(1), (7) and (8). Despite this, the Federal Committee approved the technology transfer agreement, presumably recognizing that in the case of dialyzers, where defective manufacture could be life-threatening, it was reasonable for the foreign expert in the technology to impose restrictions on the joint venture to ensure the products were safe for human use.

(c) **The Purchase Agreement:** sets forth the terms for the joint venture's purchase of materials from Baxter, and Baxter's purchase of finished products from the joint venture. The agreement also defines the mechanism by which Baxter generates the hard currency necessary for the joint venture to repatriate Baxter's profits and to enable the joint venture to pay in a hard currency for products purchased from Baxter.

(d) **The Technical Assistance Agreement:** defines the rules governing Baxter expatriate employees who will remain in Yugoslavia for prolonged periods of time at the joint-venture plant. It specifies items such as requisite housing and that Baxter, not the joint venture, will pay its expatriates. The joint venture will reimburse Baxter for these payments.

(e) **The Marketing Export Agreement:** defines where the joint venture will make its marketing efforts. The primary effort will, of course, be in Yugoslavia. The secondary efforts will be in certain other countries. The joint venture has the exclusive right to market dialyzers in Yugoslavia, and nonexclusive rights elsewhere in the world. In view of Article 42 of the Joint-Venture Law and Article 37(10) of the Long-Term Cooperation Act, no attempt was made to restrict joint-venture exports. To do so would be unwise and would almost certainly result in rejection of the agreement by the Federal Committee.

Baxter naturally was concerned that the joint venture might enter export markets which Baxter now serves with dialyzers made in Yugoslavia. However, it is not possible to preclude this by agreement in Yugoslavia; one can, however, use other legitimate techniques to minimize this. For example, the foreign party can require the joint venture to make primary, secondary, etc. marketing efforts in specified countries as long as there is no overt preclusion against the joint venture marketing its products in other countries.

Negotiations continued during the period October 1979 to May 1980. There were seven negotiating sessions, one week each, alternating between Brussels and Belgrade. The president of Zdravlje, our joint-venture partner, was present at every negotiating session. On disputed issues, he made the final decision for the Yugoslavs.

Masters

The Yugoslavs were reasonable, flexible, resourceful and masters of compromise. They understood American-style agreements and were accommodating on this point.

A common negotiating trait of the Yugoslavs was their penchant to concede a point but later raise the same point as though it had never been conceded. It therefore is important to keep a record of all points conceded by the Yugoslavs.

Another feature was the unpredictability of the issues on which the Yugoslavs would be most adamant. Prior to each negotiating session, we reviewed the points for discussion and identified those likely to be most troublesome. However, the Yugoslavs often passed quickly over those points and by contrast spent excessive amounts of time negotiating what seemed to us trivial points.

The parties signed the joint-venture agreement in Belgrade on May 14, 1980, and submitted the contracts to the Federal Committee for approval.

It was not necessary to submit all five agreements. The law requires only that the joint-venture agreement and the technology transfer agreement be submitted. However, if the remaining agreements include provisions prohibited by the Joint-Venture Law or the Long-Term Cooperation Act, these provisions would have to be deleted from such agreements and transferred to the two agreements submitted for approval, or the additional agreements would have to be submitted to the Federal Committee. We concentrated all controversial provisions in the joint-venture agreement and technology transfer agreement.

We did not hear from the Federal Committee until November 1980 (six months after submission); the committee then provided lengthy written comments and objections to the submitted agreements.

Baxter representatives returned to Belgrade to work with our Yugoslav partner deciding on how best to respond to the committee's comments. During this period, the representatives of Zdravlje interviewed members of the committee. Largely through these interviews a number of the more difficult objections were resolved. Once this logjam was broken, we dealt with the remaining comments by amending the agreements. The remaining comments were largely of formalistic nature and could be overcome by changing the wording of the agreement clause in question.

In December 1980, the partners submitted to the Federal Committee the amendments to the joint venture and technology transfer agreements. The Federal Committee approved the amended agreements in January 1981. The joint-venture plant is scheduled to go on-stream in early 1983.

Baxter recognizes that the pharmaceutical industry is opposed to Yugoslav legislation which controls technology transfer into Yugoslavia. The industry's prime concern is the trademark provision in Article 27.5 of the Medicinals Law. However, industry members are also concerned about certain provisions in the Long-Term Cooperation Act, particularly Articles 24 and 37. One might therefore expect the pharmaceutical industry to be concerned about an article such as this which portrays Yugoslav joint ventures in a favorable light.

However, Baxter did not find the Yugoslav laws on technology transfer insurmountable. Fortunately, our joint venture did not fall within the scope of the Medicinals Law. As a result, Baxter did not have to deal with the trademark provision of Article 27.5.

We dealt with the Long-Term Cooperation Act by expressly limiting our liability and by other contractual provisions to mollify the other onerous parts of the act. We encountered no substantial difficulties in having the Federal Committee approve such provisions.

Were the Baxter joint venture covered by the Medicinals Law, Baxter probably would not have proceeded with the joint venture. Baxter's attitude toward the Yugoslavs therefore is identical to that of the pharmaceutical industry in this regard.

One question arose in connection with the joint venture which was never answered to our satisfaction—what is the effect of a provision in an agreement which on its face violates Yugoslav law, but which the Federal Committee approves? If litigation later arose, would the approval of the Federal Committee be binding and the agreement be enforced according to its terms, or would the court ignore the provisions as contrary to Yugoslav Law despite their approval by the Federal Committee? This issue has not yet come before the courts. This may be because the Yugoslav laws governing joint ventures are of such recent origin that the problem has not yet had time to reach the courts.

At present, there are few western joint ventures in Yugoslavia. This is believed due to the Medicinals Law and Long-Term Cooperation Act. However, while the Medicinals Law provides formidable obstacles to licensing technology in Yugoslavia because of Article 27.5, it is not as clear that the Long-Term Cooperation Act restricts technology transfer into Yugoslavia.

Baxter found it possible to live with the Long-Term Cooperation Act and still do business in Yugoslavia without unduly risking the technology in question. The Yugoslavs were generous in permitting the inclusion of provisions not expressly prohibited by the Long-Term Cooperation Act. A study of the act convinced us there were many provisions not prohibited by the act which are available to mollify the more onerous sections of the Long-Term Cooperation Act.

Baxter found that the advantages of doing business in Yugoslavia outweighed the disadvantages of the Long-Term Cooperation Act for joint ventures whose subject matter is outside the scope of the Medicinals Law. This was Baxter's situation and if yours is similar, I recommend that careful consideration be given to the Long-Term Cooperation Act and the mollifying options permitted under Yugoslav law before a decision is made to kill the proposed project.