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MANUAL ON THE ESTABLISHMENT OF

INDUSTRIAL JOINT-VENTURE AGREEMENTS

IN DEVELOPING COUNTRIES

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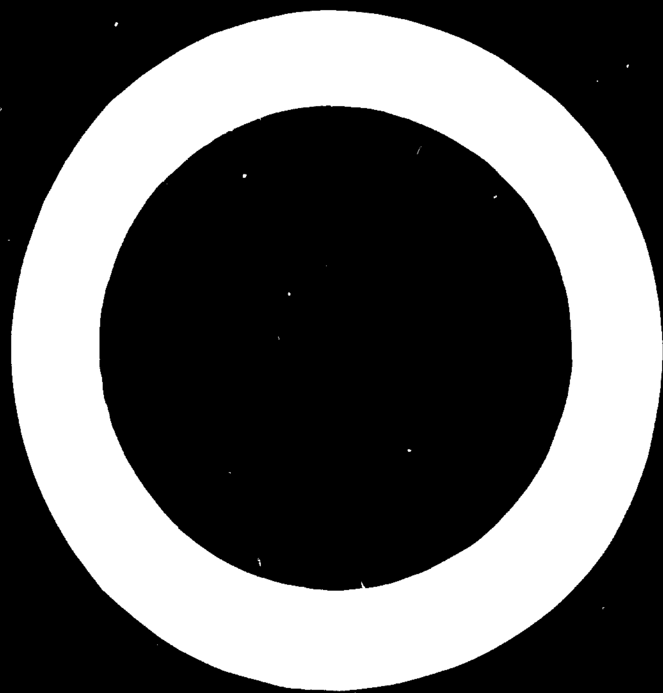
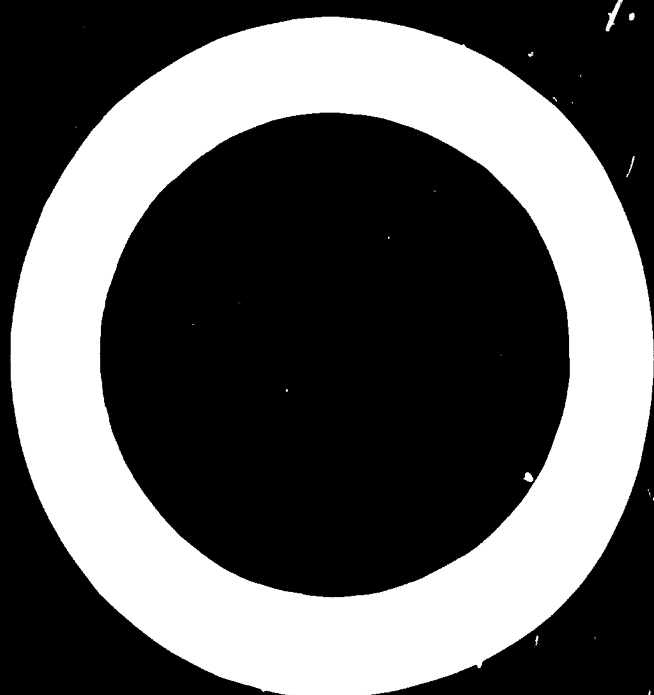
UNITED NATIONS





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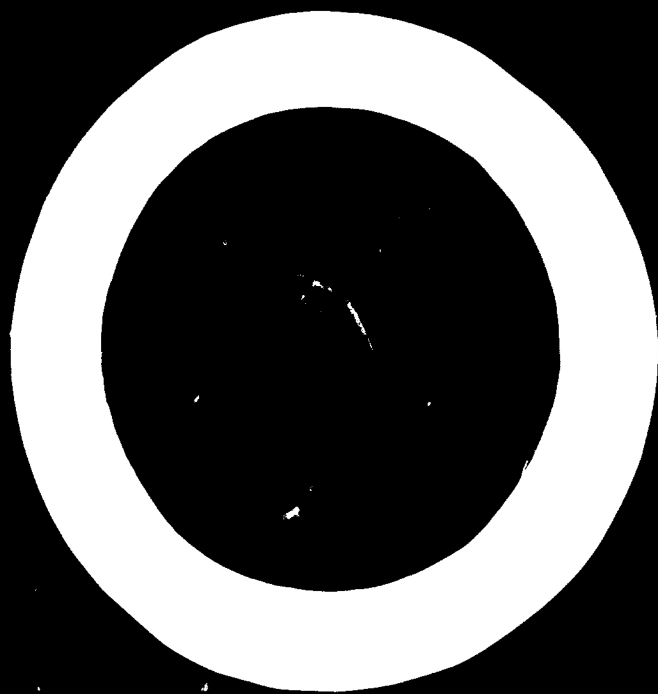

UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
VIENNA

MANUAL ON THE ESTABLISHMENT OF INDUSTRIAL JOINT-VENTURE AGREEMENTS IN DEVELOPING COUNTRIES

UNITED NATIONS
New York, 1971

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INTRODUCTION

Historically, foreign direct investment in developing countries has generally been in the form of wholly-owned subsidiary corporations. More recently, however, a growing number of new investments have been joint ventures, involving shared ownership between local and foreign partners. There are many factors contributing to the growth of joint ventures. One is that developing countries may pass legislation either prohibiting total foreign ownership or making incentives conditional upon a certain degree of local ownership. More importantly, however, many foreign investors have become increasingly aware of the positive advantages they can derive from sharing ownership with local partners, be they private or governmental. Among these benefits are tangible contributions, such as land, capital, trained personnel, a knowledge of the local language, and familiarity with local markets, suppliers and conditions of doing business. Some intangible benefits include the goodwill engendered with employees, customers and the Government, and the decreased likelihood of nationalization or discriminatory legislation.

Because of the increase in joint ventures and the very real benefits they afford, much sophistication has been brought to the negotiation and execution of joint ventures, especially by the larger multinational corporations, which have considerable experience in this field. Recognizing this development, the International Symposium on Industrial Development held in Athens in 1967 recommended that UNIDO should

> "formulate prototype agreements which might be required by the requesting countries in connexion with bilateral, multilateral, and joint-venture negotiations; such formulated agreements should be accompanied by extensive notes on definitions, terms and conditions as well as alternative possibilities."

The recommendation of the Athens Symposium may have been overoptimistic in suggesting that a prototype joint-venture agreement might be formulated, for in UNIDO's experience, it has been impossible to find any joint venture that could be called typical or serve as a prototype for other agreements. On the contrary, it is the almost infinite number of combinations of possible terms and conditions within the context of a joint-venture arrangement that has led to their utility and popularity.

Because of this diversity, and because large multinational corporations are generally quite knowledgeable about joint ventures, this study is limited to the achievement of only two very modest objectives. First, an attempt is made to present a number of the major issues confronting the host country partners in the negotiation and execution of joint-venture agreements. Some of the topics considered are ownership, capital structure, direction, management, marketing, financial policies, industrial property, technical assistance and know-how, settlement of disputes and partnership changes.

The second objective of this study is to present some of the possible alternative approaches that might be considered by the parties. In some instances, approaches

are mentioned which might accord with certain policy goals of the host developing country. Legal clauses for implementing some of the approaches have been included in a number of instances. The main purpose of this study is to suggest some of the possible ways in which the rights of the partners might be governed to the advantage of the Joint Company itself and of the host country.

The negotiation and drafting of joint-venture agreements is a complex and difficult undertaking. Many large, multinational firms attempt to use more or less standard agreements, and these agreements often represent their initial bargaining posture. Through being aware of alternative possibilities, however, the local partners will be in a better position to ensure that the needs of the Joint Company and the host country as well as their own needs are considered.

As mentioned, there is no standard or prototype joint-venture agreement, and the rights of the partners are often governed by a series of interrelated agreements. Common to these is the joint-venture agreement itself, in which the rights of the partners in respect of the establishment of the Joint Company and its operation are governed. All other provisions may be included either in the joint-venture agreement itself, or be provided for in separate legal agreements. Where the matters to be provided for are complex and the provisions can be divorced from the other questions affecting the rights of the parties, it may be better legal practice to incorporate such matters in a separate agreement. Separate agreements may be used in respect of such matters as trade marks, trade names and patent licensing; supply of technical assistance and know-how; engineering and construction; marketing arrangements; management; supply; and others. Throughout this study, all the related agreements are referred to interchangeably as the joint-venture agreement or joint-venture arrangements.

Although it has been the experience of UNIDO that there is no standard or prototype joint-venture agreement, there appears to be one element common to all successful joint-venture relationships, namely, the compatibility of the partners. A joint venture requires that the partners work together and co-operate to attain common goals. The parties should therefore not enter into negotiations with the intention of maximizing their immediate advantages, but with a view to creating a legal structure in which they can work harmoniously over the long run to achieve results that neither could achieve alone. The object of the negotiations is primarily to create a successful marriage, not to maximize individual advantages at the expense of the whole.

It is hoped, therefore, that this study may facilitate the conclusion of successful joint-venture arrangements through its suggestion of some alternative terms that may enable partners to provide more adequately for their requirements.

FORMATION OF THE JOINT-VENTURE COMPANY

Parties

The parties to a joint-venture arrangement may be individuals, corporate bodies, Governments or government agencies; the agreements may be bipartite or multipartite. The local partner will frequently be a government agency of the host developing country, such as an industrial development corporation whose shares are wholly owned by the Government. For convenience, it is assumed throughout this study that there are only two parties: the foreign partner ("Foreign") is a developed country corporation and the local partner ("Local") is a developing country corporation.

Type of joint venture

There are two fundamental forms of joint ventures, contractual joint ventures and equity joint ventures.

Contractual joint ventures

Contractual joint ventures are often used where the laws of the country in which the business operations are to be conducted do not recognize the concept of private ownership of property, such as in a number of countries with centrally planned economies. Because of their less permanent nature, they are sometimes used as a preliminary to equity joint ventures–as a period of "engagement" preceding the "marriage" of a Joint Company. Contractual arrangements are made for the supply of capital, equipment, industrial property, technical assistance and know-how by the foreign partner to the Government or local partner in return for royalties, which may depend on production, sales, profits etc. Other contractual joint ventures may involve only licensing and know-how or marketing arrangements. Because of the more limited use of wholly contractual joint ventures, the direct concern of this study is with the equity joint venture, but many provisions relating to the equity joint venture, excluding ownership considerations, apply to contractual joint ventures as well.

Equity joint ventures

Equity joint ventures are by far the most common form of joint venture involving foreign investment in developing countries. They occasionally involve

participation by two or more partners in the equity capital of an existing company, but much more frequently in the incorporation of a new company in which each partner owns a certain portion of the equity capital. Formation of a new company may be the more practicable method, because it is often more convenient to obtain new documents of incorporation with the desired provisions than to adapt an existing structure to the new way of doing business.

Jurisdiction of incorporation

Assuming that an equity joint venture is being adopted, the partners must decide upon a suitable jurisdiction for incorporation of the Joint Company. The Joint Company may either be incorporated in the host developing country or if incorporated in some other jurisdiction, may conduct its business in the developing country through a branch of the company. Sometimes the Joint Company and/or partners may obtain small tax and other advantages from incorporating outside the host developing country, but such instances are so few that they are not considered further in this study. On the other hand, many developing countries have industrial investment incentive laws offering advantages to locally incorporated companies, and incorporation in the country where the principal operations are to be conducted usually offers many administrative conveniences. Accordingly, it is assumed throughout this study that the Joint Company will be incorporated in the host developing country where the principal operations are to be conducted.

Incorporation of Joint Company

Because the local partner will usually be in the best position to have the Joint Company organized expeditiously, this responsibility is often assigned to it. When the local partner is the Government or a government agency, the foreign partner will often take the responsibility for organizing the Joint Company. In some cases both partners assume responsibility for having the Joint Company incorporated.

The costs of incorporation are generally shared by the partners *pro rata* to their equity participation in the company, but other formulae are also applied. Costs may be shared equally, or the partner responsible for having the company incorporated may assume the costs.

Name of Joint Company

When the name of either the foreign or local partner carries goodwill, most joint-venture agreements provide that at least a portion of the name be included in the name chosen for the Joint Company (e.g. Merck Sharp and Dohme of India Limited). Another possibility is to include in the name one of the trade names under which the Joint Company's products will be sold (e.g. Carling Brewery Hong Kong Limited). The name is generally included in the application for incorporation, and provision should be made for an alternative name in case the first choice is unacceptable to the incorporating authority.

Information to be included in documents of incorporation

It is necessary to determine what provisions governing the rights of the joint-venture partners *inter se* and vis-à-vis the Joint Company should be included in the documents of incorporation of the Joint Company. The answer will depend, first, on the laws of the jurisdiction of incorporation and, second, on the extent to which the parties wish the documents of incorporation to govern their relationship.

Three ways in which the rights of the parties *inter se* and vis-à-vis the Joint Company may be protected are as follows:

(a) The rights of the partners as shareholders may be protected by company laws of the jurisdiction of incorporation which require a special majority for certain actions, thereby necessitating the consent of both or all partners to the proposed action.

(b) The rights of the partners may be protected by setting them out in the documents of incorporation of the Joint Company where either the applicable company law requires a special majority to alter the provisions of the documents of incorporation themselves or stipulates that amendments thereto may be made by a special majority only. Under either of these alternatives, the special majority must be sufficiently high so as to require the consent of both or all partners.

(c) The rights of the partners as shareholders may be protected by a shareholders' agreement or voting trust whenever the applicable law permits specific enforcement of such agreements.

One problem with shareholders' agreements and voting trusts is that in a number of civil law jurisdictions, the remedy of specific performance is not available and damages alone may be inadequate. A further problem is that the laws of many countries regard directors as fiduciaries of the company and not of the appointing shareholder's specific interest. Accordingly, agreements fettering the directors' discretion are void. Even if shareholders should enter into binding agreements to appoint certain directors, such directors may not be compelled to act according to the wishes of the shareholders, and their removal and replacement by more tractable directors may be time-consuming and difficult.

Where shareholders' agreements and voting trusts are specifically enforceable, there will be less need for the documents of incorporation to contain provisions protecting the rights of the partners *inter se* as shareholders. Accordingly, the existence of such provisions in the joint-venture agreement itself will afford adequate protection. Where shareholders' agreements and voting trusts are not specifically enforceable, or where the provisions relate to the exercise of partners by directors whose fiduciary powers cannot be fettered by agreement, it is necessary to insert as many of the protecting provisions as possible in the documents of incorporation. If the law of the jurisdiction of incorporation provides specifically for such protection (such as preemptive rights or cumulative voting for directors), it is not mandatory to insert such provisions in the documents of incorporation. For the sake of clarity and certainty, however, it may still be desirable to include them.

When special provisions are to be included in the documents of incorporation, the usual procedure is to annex them to the joint-venture agreement as a schedule. All the documents are then submitted to the appropriate authority issuing the certificate of incorporation or final authorization or approval.

SPECIMEN CLAUSES

1. *Local and Foreign (or else Local alone) shall take all necessary steps for the incorporation of a (type of corporation to be formed) corporation under the laws of (jurisdiction of incorporation), which said corporation shall be hereinafter referred to as the "Joint Company".*

2. *Local and Foreign (or else Local alone) shall cause the Joint Company to be duly organized in accordance with the terms of this Agreement, with (name for the documents of incorporation under the law of the jurisdiction of incorporation, such as "Statutes", "Letters Patent of Incorporation", "Memorandum and Articles of Association" etc.), which in the English translation shall read in substantially the form in Schedule attached hereto.*

3. *The costs of incorporating the Joint Company shall be borne equally (or according to some other formula) by Foreign and Local.*

4. *If any of the provisions contained in the said Schedule should not be approved by the appropriate authority for inclusion in the documents of incorporation of the Joint Company, then the parties agree to make such amendments thereto as shall be acceptable to the said appropriate authority without altering their purpose or intention, or failing such amendment, to take all such other steps and do such other things, including the execution of any other agreements as may be necessary, to achieve the interest and purpose of such of the provisions as may not have been found acceptable by the said appropriate authority.*

OWNERSHIP AND CAPITAL STRUCTURE

Ownership

Type of equity joint venture

Equity joint ventures can take several forms, which are often differentiated from each other according to the ownership provisions. Five of the possibilities are listed below, of which the last two are less common than the first three:

(a) Minority foreign ownership;

(b) Majority foreign ownership;

(c) Fifty/fifty ownership;

(d) Forty-nine/forty-nine ownership, with controlling shares being held by an independent third party;

(e) One hundred per cent ownership vested in one partner, the other partner having an option to acquire some or all of those shares.

A difficult problem in negotiating any joint-venture agreement is to determine the percentage of shares to be owned by each of the partners. The number and kind of shares subscribed for by each partner may depend on the degree to which each partner wishes:

(a) To participate in the profits and growth of the company;

(b) To share in the assets upon a winding up or dissolution;

(c) To have voting rights as a shareholder upon questions such as:

  (i) The appointment of directors;

  (ii) Distributions of assets;

  (iii) Changes in the Joint Company's objects;

  (iv) Changes in the capital structure;

  (v) Such other items as may be reserved to the shareholders by the documents of incorporation, by law and by agreement or otherwise;

(d) To comply with host country policy in respect of foreign ownership.

Because different types of shares may be authorized, it may be difficult to classify a joint venture according to the percentage of shares owned by each partner. For example, a 51 per cent ownership of all shares that entitle the owner to one vote per share under all circumstances may represent only a small percentage of the total

authorized capital of the Joint Company if non-voting shares are issued as well. Accordingly, when two or more types or classes of shares are authorized and issued, a reference to the percentage ownership by each partner is meaningful only if the rights attached to each type or class of share are specified; but when there is only one type or class of share, the percentage ownership will represent the percentage of control and participation unless abridged by agreement or otherwise.

As mentioned, apart from the laws of the host country, the percentage ownership each partner may wish to acquire will depend generally on one or a combination of the rights each partner may consider will be conferred by ownership of such shares. The major rights will be in respect of participation in profits and assets and in the appointment of directors who will be responsible for the management and control of the Joint Company. While these rights are commonly conferred on shareholders *pro rata* to their percentage ownership of the capital stock, alternative arrangements may make such rights independent of the number of shares owned.

In respect of profits and assets, for example, the use of different types of shares with limited rights of participation in profits or assets may be possible. In addition to compensation in the form of dividends or an ultimate participation in assets, one or both of the partners may receive financial advantages from the Joint Company that are not directly related to their percentage ownership through:

(a) Licence fees;

(b) Management fees;

(c) Directors' fees;

(d) Salaries for key personnel;

(e) Interest on debt capital or loans;

(f) Fees for special services;

(g) Indirect fringe benefits.

In respect of management and control, a minority shareholder may acquire a disproportionately large voice in the management and control of the Joint Company through:

(a) The use of different types or classes of shares;

(b) A management contract;

(c) Veto powers contained in the documents of incorporation or the joint-venture agreement;

(d) The supply of essential industrial property, technology, materials, services etc.

In other words, the percentage ownership acquired by each partner will depend on a great many factors, and the parties should realize that there exist many different legal, financial and economic means of achieving many of the objectives normally associated with percentage ownership alone.

Nominee shareholders

Although there may be only two partners of a joint venture, local company laws may require a greater number of shareholders for incorporation of the Joint Company. Nominee shareholders up to the required number may be appointed who will hold the minimum number of required shares. Although such shareholders may

be outsiders, they are more usually the chief executive officers or directors of the Joint Company, and they enter into a declaration that the shares are being held in trust for one of the partners. When a nominee shareholder ceases to be associated with the Joint Company or one of the partners, the shares will be transferred to another nominee.

SPECIMEN TRUST CLAUSE

I, (name of nominee shareholder), do hereby declare that I am the holder (number and type of shares) of (name of Joint Company) in trust for (name of partner), its successors and assigns, upon such trusts as (name of partner) shall from time to time declare, and am not the beneficial owner thereof.

Requirements for ownership by nationals

The laws of the host country may require a certain percentage of ownership by nationals, residents or domiciliaries, but the partners may not be able to agree on such a percentage. Restrictions on the degree of foreign ownership of corporations in developing countries generally take two forms: an outright prohibition against more than a certain percentage of foreign ownership; or restricting the benefit of industrial incentives, such as tax holidays, to those corporations with not more than a certain percentage (usually 49 per cent) of foreign ownership.

It has not been unknown among joint ventures in developing countries for the foreign partner to subscribe for the maximum number of shares permitted by host country law (e.g. 49 per cent), but still to achieve the desired control and participation by having nominee shareholders who are citizens or residents of the host country own but hold in trust for the foreign partner a certain number of shares (e.g. 2 per cent). Where such trusts contravene in letter or spirit the law of the host country, their existence has sometimes been kept secret from the government authorities. This approach to conducting business in developing countries cannot be condoned even on the ground of business exigencies, because both partners must be a party to the deceit, and there are generally other ways of allocating the required control and participation among the partners which can satisfy the legitimate aspirations of each partner.

Capital structure

Type of share capital

The partners must decide what type of capital shares of the Joint Company are to be authorized, and what rights each type of share shall confer upon the shareholder.

Common, or ordinary, shares

Holders of common, or ordinary, shares own the equity in a company. After servicing prior charges such as fixed interest due to debenture holders and fixed rates of dividend due to preference shareholders, if any, the balance of the earnings of the

company belong to the ordinary shareholders and can either be distributed among them as ordinary dividends or be carried to reserve and credited to them as undistributed earnings. The ordinary shareholders are therefore the ultimate beneficiaries of the profits made by the company, and they stand to gain or lose, to sink or swim with the fortunes of the company. When the company is finally wound up and the claims of the company's creditors, debenture holders and other persons ranking ahead of the ordinary shareholders at the dissolution have been met, the remainder of the assets will be distributed among the ordinary shareholders. If the company is sold by its original owners to another company at a substantial profit, the ordinary shareholders will be the principal gainers; if, on the other hand, the company fails, they will be the principal losers.

Preference shares

In many jurisdictions, it is possible to create shares which carry special rights or preferences such as the following:

(a) Dividends. Preference shares may give a preferred right to dividends of a fixed amount before dividends are paid on the common shares. The right to dividends may be cumulative or non-cumulative. If non-cumulative, and dividends are not declared in one year, they do not accumulate and become payable the following year.

(b) Participation in assets. On dissolution or winding up, preference shares will usually participate up to their face value in the assets of the company in preference to the common shares.

(c) Voting. Preference shares may be voting or non-voting. It is common to provide that when their specified dividend is not paid for three consecutive years, for example, the non-voting preference shares become entitled to one vote each.

(d) Redemption. If the Joint Company wishes to terminate any of the preferences on the common shares or to terminate its liability with respect thereto, they may be made redeemable at the option of the joint company.

Special classes of shares

In some jurisdictions (some civil law jurisdictions for instance), it is not possible to have non-voting shares nor to obtain specific enforcement of a shareholders' agreement to appoint certain persons as directors. In such a case, different classes of shares may be created with each class having the right to appoint a specified number of directors. In this way, each partner can be assured of its own representation on the board.

SPECIMEN CLAUSES

The Joint Company shall have an authorized capital of (amount) consisting of:

1A. (number) common (or ordinary) shares with par value of (amount) each (or without nominal, or par value).

or

1B. (a) (number) Class A shares of a nominal value of (amount) each; and

(b) (number) Class B shares of a nominal value of (amount) each.

(c) The said Class A shares shall be entitled to appoint (number) directors of the Joint Company, and the said Class B shares shall be entitled to appoint (number) directors of the Joint Company.

2. *(number) (interest rate) non-voting (or voting) cumulative (or non-cumulative), redeemable (or non-redeemable) preference shares with a par value of (amount) each.*

3. *(number) (interest rate) non-voting (or voting), cumulative (or non-cumulative), convertible preference shares with a par value of (amount) each, which said shares shall be convertible into common shares on the basis of one preference share for one common share any time after the last business day of the calendar year 19__.*

Payment for shares

Depending upon the requirements of local laws, shares may be issued to the joint-venture partners as fully paid or as partially paid with the balance remaining on call. When not fully paid, it is usual for the directors to make calls from time to time as further capital is required by the Joint Company.

Payments for shares may be made in the form of:

(a) Cash;

(b) Machinery and equipment;

(c) Land;

(d) Industrial property, including patents, trade marks, trade names; technical data and technical assistance and know-how;

(e) Other services.

Cash

Depending upon the availability and terms of debt financing, most joint-venture companies will attempt to establish a high debt to equity ration. The amount of cash paid in by the partners will depend to a large extent on what additional capital is required to meet initial construction and operating costs, upon requirements of creditors that a certain percentage of cash be paid in, and local company laws, which may require certain cash subscriptions. Generally, however, the partners will attempt to keep their cash subscriptions to the capital of the Joint Company as low as possible.

Machinery and equipment

The partners, often the foreign partner, may contribute machinery and equipment to the Joint Company. The value of such machinery and equipment may be regarded as a contribution to capital by the supplying partner or partners.

Land

If one of the partners supplies land, it may be regarded as a contribution to the capital of the Joint Company to the extent of its value.

Industrial property

For the purposes of this study, it is assumed that industrial property consists of property such as patents, trade marks and trade names, which are often protected against unauthorized use by laws requiring their registration; and property such as secret processes, technical information and data, and know-how, which may or may not be protected against unauthorized use by laws in respect of fair business practices.

Technical data generally include all the information concerning the operations of the Joint Company which can be transferred by writing, models etc. It may include such items as formulae; inventions whether patentable or not; secret processes and technical information relating to the production, use and sale of products; manufacturing, engineering and test data; specifications; application instructions; information regarding raw materials, their sources and uses, and methods for analysing and controlling their quality; and sample copies of labels, publicity and advertising materials. The provision of technical data to the Joint Company by one partner can generally be regarded as a contribution to capital.

Assignment. In most instances, the Joint Company will derive the greatest advantage from receiving a transfer or assignment of the industrial property rights held by the partners because it will then have the right to exploit that property in all countries whose laws permit it to do so. In addition, if the Joint Company becomes the owner rather than a licensee of the industrial property, it will be freed from the other constraints upon its use normally contained in licence agreements.

Licensing. While, as mentioned, it will usually be most advantageous for the Joint Company to become the outright owner of the industrial property it will use in its operations, this course may not be open to it because the contributing partner demands too high a price or wishes only to license its use. The contributing partner may be reluctant to assign industrial property rights to the Joint Company when it is using them elsewhere in the world and is in a position to derive substantial profits from such licensing operations. The alternative is for the Joint Company also to become a licensee of the foreign partner. Licence royalties may be paid on a lump-sum or continuing basis, or a combination of both. When an exclusive world licence is granted to the Joint Company in return for a lump-sum royalty, such a licence may in some limited instances be considered an assignment, and the lump-sum, rather than being paid to the contributing partner, may be treated as a contribution to capital.

Royalties payable on a continuing basis to the licensor partner, instead of being actually paid, may also be used to offset such partner's liability for calls on shares, and in this way, may be regarded as part of his contribution to capital.

Sublicensing. When a partner is a licensee of industrial property and by the terms of the licence is not prevented from sublicensing to the Joint Company, lump-sum and/or continuing royalties for the sublicence may go to reduce the foreign partner's obligations to contribute to capital.

The assignment, licensing and sublicensing of such industrial property may in certain cases be treated as a contribution to the capital of the Joint Company, in return for which fully paid shares may be issued to the contributing partner to the extent of the value thereof.

Technical assistance and know-how. The term "technical assistance and know-how" includes generally all information and aid required to carry out the manufacturing and business operations and to use effectively the industrial property owned by or licensed to the Joint Company. In its broadest connotation, it embraces "technical data", but as used more narrowly in this context, technical assistance and know-how consist principally of services training employees of the Joint Company in conjunction with the transfer of technical information and industrial property in all the operations required for the production, sales and servicing of the products being manufactured. Whether these services, consisting mainly of interpersonal contacts, may be treated as a contribution to capital depends on the laws of the host country, which should be closely scrutinized in this connexion.

Other services

Where the jurisdiction of incorporation permits contributions to capital in the form of services rendered by the partners of the Joint Company, such as in organizing the company, shares may be issued to the contributing partners in consideration for the services rendered.

SPECIMEN CLAUSES

In payment for the shares of the Joint Company to be acquired by Foreign (Local) at the time of the incorporation of the Joint Company (or, within ____ days after the incorporation of the Joint Company), Foreign (Local) shall assign and transfer to the Joint Company:

1. Cash: *(amount) in cash.*
2. Machinery and Equipment: *all the machinery and equipment set forth in Schedule ___ annexed hereto, which said machinery shall become the sole property of the Joint Company, free and clear of all liens, charges and claims of any kind whatsoever.*
3. Land: *the absolute title, free and clear of all liens, charges and claims of any kind whatsoever, to the real property and all buildings and other structures thereon, including all fixtures, equipment and machinery located therein, situated at (municipal address), which said real property, buildings, structures, fixtures, equipment and machinery are more specifically described in the Schedule annexed hereto.*
4. Industrial Property:

   (a) Assignments:

   (i) Patents: *Foreign's entire right, title and interest in and to all unexpired patents and patent applications theretofore issued or assigned to or filed by Foreign anywhere in the world to the Licensed Products or to the production, manufacture or use thereof (a list of such patents and patent applications heretofore issued or assigned to or filed by Foreign being set out in the attached Schedule), together with all rights which Foreign then has*

to apply for patents in the territory[1] *on inventions relating to the Licensed Products or to their production, manufacture or use, and including all of Foreign's rights with respect to patents which may thereafter issue anywhere in the territory or any such patent applications and with respect to divisions, patents of addition, continuations, renewals, re-issues and extensions of all such patents, patent applications and patents which may issue on such patent applications;*

(ii) Trade Marks and Trade Names: *Foreign's entire right, title and interest in and to all rights in the territory which it then has to all of the following trade marks and trade names, namely: (to all the trade marks and trade names set out in the attached Schedule);*

(b) Licences: *Foreign shall enter into a Licence Agreement with the Joint Company in the form as set out in Schedule____ hereto annexed, under which said Licence Agreement the Joint Company shall become the exclusive licensee for the world for all unexpired patents and patent applications of Foreign for the Licensed Products or to the production, manufacture or use thereof, together with all rights which Foreign then has to apply for patents in the territory on inventions relating to the Licensed Products or to their production, manufacture or use, and including all of Foreign's rights with respect to patents which may thereafter issue anywhere in the territory or any such patent applications and with respect to divisions, patents of addition, continuations, renewals, re-issues and extensions of all such patents, patent applications and patents which may issue on such patent applications;*

(c) Sublicences: *Foreign's entire right, title and interest in and to all rights in the territory which it then has under patents owned by others relating to the Licensed Products or to their production, manufacture or use, a list of Foreign's present rights under such patents being set out in the attached Schedule.*

5. Technical Data: *Foreign's entire right, title and interest in and to the use in the territory of all Technical Data which Foreign is then entitled to use anywhere in the world; and thereafter during the term of this Agreement, Foreign shall assign and transfer promptly to the Joint Company any and all rights in the territory with respect to Technical Data relating to the Licensed Products and all other products being manufactured by the Joint Company, which Foreign shall acquire during such term incidental or relating to such products;*

   Foreign shall take all such action and shall execute all such documents as the Joint Company may deem necessary or desirable to effect, perfect or confirm, record or otherwise, the transfers and assignments to the Joint Company referred to above, including, without limitation, the full and complete disclosure to the Joint Company of Foreign's Technical Data, and lists of Foreign's distributors and customers for all of the Licensed Products

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[1] The term "the territory" shall mean (countries intended to be covered by operations of the Joint Company).

and other products produced or sold by Foreign which may be similar to the products manufactured or sold from time to time by the Joint Company;

In the above Sections, the term "Technical Data" shall mean formulae, inventions, whether or not patentable, secret processes and technical information relating to the products and to the production, manufacturing, engineering and test data, specifications, application instructions, information regarding uses, raw materials and methods for controlling and analysing quality, and sample copies of advertising and publicity materials, except that information received in confidence from others or information forbidden to be disclosed by virtue of any law or governmental regulation restricting the dissemination of such information shall not be included.

Chapter 3

DIRECTION AND MANAGEMENT

Board of directors

In most jurisdictions, the board of directors of a company is responsible for its management and control, which includes the establishment of over-all corporate policies. Among other things, the board appoints the officers who implement the policies of the board and administer the company's affairs from day to day. Depending on the laws of the incorporating jurisdiction, corporate bodies as well as individuals may hold a seat on the board; if a corporation is a member of the board, it will designate some individual or representative to occupy that position.

The board usually acts through resolutions by majority vote, and is composed of directors appointed by each partner in proportion to its ownership of the Joint Company. These aspects of the Joint Company may be altered, however, in tailoring the board to meet the particular needs of the partners.

Size of board

The partners must decide on how many directors the Joint Company will have. There is no optimum size of board for all circumstances. Some factors which will influence its size are:

(a) The minimum number of directors prescribed by the laws of the jurisdiction of incorporation;

(b) The number of partners deserving representation on the board;

(c) The percentage control of each partner;

(d) The ability of each partner to provide suitable directors;

(e) The desirability of having many different points of view and expertise on the board;

(f) The requirements for a special majority for board decisions;

(g) The requirements of business efficiency.

Partners' representation on the board

The partners must decide how many representatives each is to have on the board of directors. It is common in joint ventures for the representation of each partner on the board to reflect the ownership of the partners, but other alternatives also exist.

Besides having control through directorships in direct proportion to ownership, a minority owner may want representation on the board equal to, or greater than, the representation of the majority owner.

One area in which either of these approaches might be useful is where, for instance, local law prohibits majority foreign ownership but the foreign partner insists on majority representation on the board. Another is where the partners decide that it is most convenient and practicable for the local partner to exercise control of the Joint Company through a greater representation on the board than his shareholdings might otherwise entitle him.

To facilitate the convening of meetings, the partners will usually wish to have local residents as their representatives on the board. If the board is to include non-residents as well, it may be convenient to appoint an executive committee composed of residents. The foreign partner will usually find it most convenient to choose his representatives to the board from among those of his employees who are working for the Joint Company.

Election of directors

Directors are normally elected by majority vote of the shareholders. In the absence of cumulative voting requirements in either the documents of incorporation or local company laws, the majority shareholder would be able to elect all the directors. It is necessary, therefore, to assure that each partner is able to secure his agreed-upon representation on the board. This can be done in several ways.

Binding nominations

In jurisdictions where shareholders' agreements are specifically enforceable (most common law jurisdictions), provision in the joint-venture agreement that each partner shall have the right to nominate a specific number of directors will suffice. In addition, such provisions should be inserted in the documents of incorporation where permitted.

Different classes of shares

Where shareholders' agreements are not specifically enforceable, such as in some civil law jurisdictions, different classes of shares, each bearing the right to nominate a specific number of directors, can be issued. Such provisions are naturally contained in the documents of incorporation.

SPECIMEN CLAUSES

A. **Binding nominations:**

(Number) Directors shall be appointed by Foreign, (number) by Local. In their capacities as shareholders, Foreign and Local agree that they shall nominate (number) and (number) directors respectively, and that each shall vote for the nominees of the other.

or

B. Alternative clause:

The affairs of the Joint Company shall be managed by a Board of (number) Directors, (number) of whom shall be nominated by Foreign and (number)

of whom shall be nominated by Local. Foreign and Local shall each vote all shares in the capital stock of the Joint Company owned or controlled by them for the election and maintenance in office of the persons so nominated.

Foreign and Local agree that prior to the annual meeting of the shareholders of the Company, each will inform the other of the names of (number) persons qualified in all respects to be elected, such persons being hereinafter referred to as "nominees", and each will support or cause to be supported at each annual meeting the election as directors of the Company for the ensuing year of the (number) nominees so selected, by nominating or seconding their names as candidates, by voting in favour of their election, and by supporting their election in any other fashion which may appear necessary. In the event that either Foreign or Local shall fail to notify the other prior to any annual meeting of the names of its (number) nominees, then it shall be deemed to have selected as its nominees the nominees representing it on the Board of Directors of the Joint Company immediately prior to the annual meeting.

or

C. Different classes of shares:

As registered owner of the Class A shares, Foreign shall be entitled to make binding nominations for the appointment of (number) directors, and Local, as registered owner of the Class B shares, shall be entitled to make binding nominations for the appointment of (number) directors. Both Foreign and Local agree to take all steps necessary to secure the appointment of the above said nominees in accordance with the laws of (jurisdiction of incorporation of Joint Company).

Replacement of directors

It is necessary to assure means by which the partners can easily replace their nominees on the board of directors. Whereas in large corporations whose shares are widely held management may tend to seek safeguards against replacement by adopting policies such as staggered voting for directors, the boards of directors of joint-venture companies, at least while in their infancy, generally are constituted to reflect closely the interests of the partners. It may be best to stipulate in the documents of incorporation, if possible, that casual vacancies on the board are to be filled by the shareholders. If, however, the local company law provides that casual vacancies are to be filled by the directors and that the exercise of the directors' discretion may not be fettered by agreement, the replacement of directors by nominees of particular partners will require the co-operation of all the directors.

SPECIMEN CLAUSE

In the event that between annual shareholders' meetings of the Joint Company, either Foreign or Local wishes to replace any or all of its nominees on the Board of Directors of the Joint Company, the other shall join in all necessary acts, steps and proceedings, and shall cause the shares of the Joint Company to which it is beneficially entitled to be voted in favour of the removal of such nominee or

nominees, of the transfer of the qualifying share or shares of such nominee or nominees to the person or persons selected by Foreign or Local, as the case may be, and of the election in his or their place and stead of a qualified person or of qualified persons selected by the party hereto whose nominee shall have been so removed.

Nothing contained in this Agreement is intended or shall be construed to bind the parties hereto or their nominees on the Board of Directors of the Joint Company as to the method or manner of the exercise of the discretion vested in them as directors of the Joint Company concerning their management of the affairs thereof. All clauses of this Agreement will be read subject to the provision of this paragraph.

Executive committee

Where a large board is decided upon, it may be found convenient to create among other special committees an executive committee of the Board, often consisting of three members of the board, to whom the board may delegate some or all of its powers. The executive committee may be composed of individuals resident in the host country and carry out all the powers of the full board between its annual meetings. Where permitted by local law, the members of the executive committee will usually be officers or employees of the Joint Company. Provision for an executive committee is generally made in the documents of incorporation, usually by a clause stipulating that the board of directors may delegate some or all of its powers to a committee (or committees) consisting of directors.

SPECIMEN CLAUSE

The Directors may delegate all or any of their powers to committees, consisting of such one or more of their body as they think fit.

All committees so formed shall in the exercise of the powers delegated to them, and in the transaction of business, conform to any mode of proceedings and regulations prescribed by the Directors, and subject thereto may regulate their proceedings in the same manner as the Directors may do.

Decisions of the board

Because the company law of most jurisdictions provides that decisions of the board are to be taken by majority vote, and because a simple majority may permit the nominees of one partner to make all decisions, provision must be made to protect minority interests. This can be done in several ways.

Special majority

A basic provision of most joint-venture agreements is that a special majority vote of the directors is required to decide all questions fundamental to the joint company and the relations of the partners to it. The special majority must be large enough to include at least one director nominated by each minority partner. Thus, the nominee directors of minority partners are given a veto power over all such decisions.

All requirements for a special majority or a minimum vote by directors should be inserted in the documents of incorporation of the Joint Company. Rather than specifying merely that a decision may be made "by a simple majority vote of those directors present and voting,", it is better to stipulate the exact minimum number of votes required, since it ensures that the vote of at least one nominee of all partners will be required to pass a directors' resolution.

When the partners decide that such a veto power by each partner is not necessary for all decisions of the board, the following is a list of items on which it is common practice to require a special majority vote or veto power:

(a) Appointment of chief executive officer;

(b) Appointment of other officers;

(c) The sale of a substantial portion of the assets of the Joint Company;

(d) Loans by the Joint Company to shareholders;

(e) Choice of auditors;

(f) Dissolution on liquidation;

(g) Increases in the authorized capital;

(h) Decreases in the authorized capital;

(i) Transfers of shares;

(j) Changes in the joint-venture agreement;

(k) Issues of new shares.

Unanimity

Another possibility is to require unanimity of the directors on all decisions. This approach may be practical when the board is small, but on a large board, it may unnecessarily impede the board's efficiency.

Simple majority

In a 50/50 joint venture, where the two partners nominate an equal number of directors, a simple majority vote will suffice to protect minority interests, provided there is no provision for the chairman or any other director to have a casting, or tie-breaking, vote in the event of a deadlock.

Casting vote

The laws of the jurisdiction of incorporation may entitle the chairman of the board to have a casting vote in the event of a deadlock, but it is usually possible to counteract this through a clause in the documents of incorporation.

SPECIMEN CLAUSES

A. Simple majority:

All decisions of the Board of Directors shall require an affirmative vote of at least (number–it should be half of the total number of directorships plus one) directors.

or

B. Special majority

All decisions of the Board of Directors shall require an affirmative vote of at least (number it should be at least the total number of nominees of the partner with the largest number of nominees on the Board, plus one for each of the other partners) directors

and/or

C. No casting vote

The Chairman shall not have a casting or second vote in the event of a deadlock.

Quorum and notice

When the vital interests of the minority partner are not involved in a question to be decided by the directors, and therefore a special majority vote or veto power may not be desired, it is nevertheless necessary to assure that the nominees of the minority partners have a right to participate in the decision-making process. By requiring that the directors receive prior notice of all issues to be discussed at directors' meetings, the partners can prepare their points of view, and they will be kept informed on the affairs of the Joint Company.

In addition, it may be desirable to provide that the directors may take a number of decisions without a specified quorum being present. Under the law of many countries, a directors' meeting may consist of as few as two directors. Reasonable notice to all directors may be an adequate safeguard against unauthorized assumption of power by certain directors. An even surer safeguard is to stipulate a quorum that will be large enough to require attendance by at least one nominee director of each of the partners. For convenience, it is often provided that in lieu of a resolution of a duly constituted meeting, a resolution will be considered valid if agreed to in writing by all directors.

SPECIMEN CLAUSES

1. Notice:

Prior written notice of all directors' meetings shall be sent to all directors at least fourteen days before the meeting, specifying the time and place of the meeting, and indicating all matters to be considered thereat, and including copies of reports, studies etc., relating thereto.

Notice may be waived by the unanimous consent of all directors (in writing).

2. Quorum:

A quorum of a meeting of the directors shall consist of (number- at least large enough that it cannot be constituted unless at least one nominee of each partner is present) directors.

Where a quorum is present, a simple majority vote of those present and voting shall suffice to pass a resolution, excepting where, as referred to herein, a special majority is required.

In lieu of a validly constituted meeting as above described, any directors' resolution shall be considered to have been validly passed if consented to in writing by all the directors.

Executive officers

One of the most important problems encountered in every joint-venture arrangement is to maximize the employment of local personnel in the Joint Company on the one hand, and to ensure that the company receives the best possible management and direction on the other. It is generally agreed that the long-run interests of a developing country are best served if the participation of properly trained and qualified personnel from the developing country in all offices of the Joint Company, including the chief executive office, is maximized.

From the developing country's point of view, maximum participation by local personnel increases the country's level of technical and administrative expertise. The Joint Company also benefits because the salaries of locally recruited personnel are based on the scale of the host country rather than on a foreign scale. The foreign partner benefits because top executives cannot generally be spared for long periods from the head office, and this fact has often been cited by executives as one of the major deterrents to undertaking operations in developing countries. On the other hand, one of the most important contributions of the foreign partner to the joint venture is to furnish experienced and competent personnel to ensure that the Joint Company's operations are conducted in the most competent and profitable manner. The requirements for localization on the one hand and executive competency on the other are not incompatible, however, if the personnel provided by the foreign partner assist in training local staff to assume maximum and even complete responsibility as expeditiously as possible.

Chief executive officers

The question as to which side should appoint the chief and other executive officers is normally a crucial issue in the negotiations leading to the formation of a joint-venture company.

One chief executive

If the chief executive officer (president or managing director) is to be appointed initially by the foreign partner, provision should be made in a shareholders' agreement or in the documents of incorporation of the Joint Company for approval of his appointment after a specific period by the local partner. In adopting this approach, each partner must be satisfied as to the competence and desirability of the individual appointed.

Alternating chief executives

Another approach is to provide that the right to nominate the chief executive officer shall alternate between the partners after the expiration of each term of, for example, two years. This system gives local personnel the opportunity to assume responsibility and achieve on-the-job training, but it does not make consultation of the other partner a prerequisite and thus works against the key principle of every joint-venture relationship, namely, co-operation between the partners.

Joint chief executives

Another possibility is to have joint officers, such as joint presidents or managing directors, with each partner appointing his own nominee. This approach ensures that

a nominee of each partner has the same right to all corporate information, and furthermore, that on-the-job training of the local nominee will be as intensive as possible. It may not be a practical approach, however, unless the two nominees are highly compatible.

Functional chief executives

One approach frequently adopted is to divide the corporate responsibilities on functional lines, such as administrative and technical. The chief executive officer, for example, the president, may be the nominee of the local partner and may be responsible for all non-technical questions in the day to day management. The executive vice-president, for example, may be the nominee of the foreign partner who is providing the technical data, information, assistance and know-how to the joint venture and may assume responsibility for all technical problems. This approach at least recognizes the reality of most business operations, which is that the chief executive officer does not necessarily possess expertise on all aspects of production and delegates these responsibilities to an expert. Furthermore, as the chief executive officer, the nominee of the local partner is in an ideal position to oversee operations and call upon the nominee or nominees of the foreign partner for advice and assistance.

The functional distribution of offices between nominees of the partners can be carried out at all senior executive levels, with appointees of the foreign partner assuming vice-presidential posts in respect of, for example, production, finance, foreign sales etc.; and nominees of the local partner occupying posts in respect of, for example, domestic sales, publicity, personnel, government relations and supply. In any functional division of powers, it is desirable that local personnel be trained as quickly as possible to assume all operations; and, accordingly, assistant positions manned by local personnel may be created for each of the posts occupied by nominees of the foreign partner until such time as they may be replaced.

SPECIMEN CLAUSES

A. One Chief Executive:

The Chief Executive Officer (President or Managing Director) of the Joint Company shall be a nominee of Local (or Foreign).

or

B. Alternating Chief Executives:

The Chief Executive Office of the Joint Company shall be the office of the President (Managing Director).

The first President (Managing Director) of the Joint Company shall be a nominee of Foreign (Local), who shall hold such office until the second annual meeting of the Company, at which time he shall be replaced by a nominee of Local (Foreign). The said appointee of Local (Foreign) shall hold such office for the ensuing two years, and then, and for every two years thereafter, the right to nominate the President (Managing Director) shall alternate between Foreign and Local.

or

C. Joint Chief Executives:

The Joint Company shall have two chief executive offices, both of which shall carry the same authority and position, and which shall be occupied by two persons, each called a Joint President (Joint Managing Director). Both Foreign and Local shall nominate one Joint President (Joint Managing Director) each.

or

D. Functional Chief Executives:

1. *The Chief Executive Officer (President or Managing Director) of the Joint Company shall be a nominee of Local.*
2. *The duties and responsibilities of the said President (Managing Director), without enlarging or restricting the duties and responsibilities devolving upon him by the law of (country of incorporation), shall be to administer all the affairs of the company, subject to Sections 3 and 4 hereof.*
3. *The Joint Company shall also have an executive office to be held by an individual whose position is that of Executive Vice-President–Production (Executive Vice-President–Engineering).*
4. *Without limiting the duties and responsibilities of the Chief Executive Officer as outlined in Section 2 hereof, the principal responsibilities of such Executive Vice-President–Production (Executive Vice-President–Engineering) shall be to superintend all technical aspects of production, including, without limiting the generality of the foregoing, the use of industrial property, technical data and assistance, inputs, machinery and equipment; training of technicians; maintenance of machinery; and the performance of all other duties necessary to meet the production standards required of the Joint Company.*

Training obligations

In conformity with the policy of localizing the Joint Company as quickly as possible, the parties may wish to insert a clause in the joint-venture agreement stipulating the obligations of the foreign partner to train local personnel.

SPECIMEN CLAUSE

Whereas Foreign and Local recognize that as expeditiously as sound business practice will permit, all officers and employees of the Joint Company should be recruited locally in (host country), they hereby agree that all officers and employees of the Joint Company who are appointees of Foreign, recruited from outside (host country), or recruited by Foreign, shall, in addition to their normal responsibilities and duties as officers and employees of the Joint Company, be responsible for assisting to train individuals recruited locally in (host country) in all aspects of their office or employment with a view to ensuring that as many of the offices of the Joint Company as possible shall be or become occupied by such locally recruited individuals.

Appointment of officers

The establishment of the posts of the officers of the Joint Company is provided for in the documents of incorporation. In most jurisdictions, officers are appointed by the directors of the company. In many jurisdictions, directors are regarded as fiduciaries of the company and not of particular shareholders. Accordingly, neither the directors nor the shareholders who appoint them can enter into enforceable contracts to limit the powers of the directors or to fetter their discretion, such as by stipulating the appointment of particular officers.

There will be little difficulty in securing the appointment of nominees of particular partners to the various posts when the partners are on good terms because the directors will co-operate to appoint the individuals agreed upon. When the parties are in disagreement, however, the question will be more difficult.

Although, as mentioned, a shareholders' agreement for the appointment of officers may be unenforceable, it is nevertheless common practice to include such provisions in the joint-venture agreement, including clauses providing for co-operation in the event of their unenforceability in order to substantiate the original intentions of the partners. Furthermore, co-operation can be assured if the documents of incorporation of the Joint Company require a special majority for the appointment of officers, which special majority will require the consent of at least one director appointed by each of the partners.

SPECIMEN CLAUSES

1. ***The parties hereto agree to take all steps open to them to support and secure the appointment of the nominee of Local (Foreign) to the office of President (Managing Director), the nominee of Foreign (Local) to the office of Executive Vice-President – Production, and the nominee of (include here any other offices to be created and occupied by nominees of particular partners), and shall continue to do so from time to time throughout the term of this agreement.***

2. ***In the event that any of the above provisions shall be held by any court of competent jurisdiction to be invalid, the parties hereto agree to co-operate in the revision of these presents in order to ensure that the intent of this Agreement is carried out in so far as is legally possible.***

Chapter 4

FINANCIAL POLICIES

Profit policy

The Joint Company must decide on whether its profits are to be retained or distributed to the partners. Some of the principal purposes for retaining profits are as follows:

(a) Working capital;

(b) Expansion of production and sales facilities;

(c) Acquisitions;

(d) Replacement of capital assets;

(e) Retirement of debt;

(f) Redemption of capital stock;

(g) Compliance with local laws or the conditions of issuance of some of the capital stock of the Joint Company, requiring certain compulsory reserves etc.;

(h) Compliance with foreign exchange controls preventing the expatriation of profits from the host country.

Apart from the usual reasons, profits are frequently distributed in order to obviate special taxes on undistributed earnings. If either partner consolidates his balance sheet and profits and loss statements with those of the Joint Company, there may be less incentive to distribute profits, because the net worth and earnings of each will reflect those of the Joint Company. This is especially true if either partner is a public company, the value of whose shares will often be determined by a certain earnings multiple, or which is expecting to take over or be taken over by another company on the basis of book value. If the Joint Company appears to be in danger of failing, both partners will probably want to recover as much of their investment as possible by distributing whatever profits there may be.

If the taxes paid by the Joint Company on its profits and retained earnings are less than the taxes paid by each partner on distributed earnings, there may be an incentive to retain profits.

Generally, confidence in the long-term success of the Joint Company will motivate the partners to retain a substantial percentage of earnings. It would appear that the greater the earnings retained by the Joint Company, the greater will be the economic advantages to the host country and to the company in the long run.

Accordingly, the partners may adopt financial policies that encourage the greatest possible retention of profits. Working against this approach may be the desire of one or both of the partners to receive a fair return on investment.

The partners, especially the foreign partner, can derive profits from the Joint Company through:

(a) Dividends;

(b) Interest;

(c) Royalties;

(d) Management fees;

(e) Fees for provision of technical data, information and know-how;

(f) Salaries paid to their personnel who are employed by the Joint Company;

(g) Increases in their own net worth from consolidated accounting principles.

In the absence of prohibitions against distribution, the following approaches may be adopted to ensure the greatest possible retention of profits in the Joint Company:

(a) Compulsory reserves. The joint-venture agreement may stipulate that compulsory reserves are to be established before dividends may be paid. It is impossible within the scope of this study to suggest a compulsory reserve formula applicable to all cases, but some possibilities are to express it as an absolute amount; as a fixed percentage of profits; as a progressively increasing percentage of profits.

(b) Prior uses of profits. When the partners can foresee specific uses for profits, the joint-venture agreement may specify that no profits may be distributed until such uses are satisfied.

(c) Indication of intention. When the partners feel that either of the above two approaches may be too inflexible, joint-venture agreements commonly stipulate that the partners recognize the desirability of retaining as much of the profits as possible in order to provide for the greatest possible growth for, and the greatest financial viability of, the Joint Company.

SPECIMEN CLAUSES

A. The parties hereto recognize that their own and the best interests of the Joint Company will be best served by taking all reasonable steps to ensure the expansion of the production facilities of the Joint Company as rapidly as market conditions permit, and to this end, agree to retain sufficient earnings in the Joint Company before distributing profits to the shareholders, as shall be reasonably required in the circumstances to provide for such expansion and for the other requirements of conducting the affairs of the Joint Company according to sound business practices.

or

B. Before any profits of the Joint Company shall be distributed as dividends to the shareholders thereof, _____ per cent of each year's net after-tax profits shall be set aside to meet the capital and other requirements of the Joint Company.

Auditors and books of account

The Joint Company must adopt accounting procedures which will represent accurately its financial status and so provide the directors with the requisite data for making sound business decisions. In a wholly-owned operation, the books of account do not necessarily have to reflect the true worth of the company. They may be designed, for example, to minimize taxation by taking maximum allowable depreciation. In joint ventures, however, the books must satisfy the needs of the partners as well, so that they can ascertain the true state of their investments. Where reserve funds are called for, the accounting methods must be consistently applied from year to year and on a basis that is thoroughly understood by the partners.

Most joint-venture agreements provide first, that the auditors must be acceptable to all partners; and second, that they shall be an internationally recognized firm of auditors. This latter provision is usually adopted because the foreign partner wishes to have auditors who use accounting practice with which he is familiar, and also because of the frequently expressed complaint that it is difficult to find competent auditors in developing countries.

Where, however, competent local auditors can be found, two major advantages in using them will be, first, that their services often cost less than those of foreign auditors; and, second, they may be more familiar with local administrative practices and have closer contacts with local officials, which can often obviate many difficulties. Under the laws of many countries, the auditors are selected annually by the shareholders. The partners may appoint a firm of auditors in the joint-venture agreement, or else provide in the documents of incorporation for the appointment of auditors by special majority vote so as to secure the approval of all partners.

SPECIMEN CLAUSES

1. *Proper books of account and other records shall be kept regarding all transactions entered into by the Joint Company and shall be freely accessible to the partners at all reasonable times.*

2A. *The auditors of the Joint Company shall be (name of selected accounting firm).*

or

2B. *The auditors of the Joint Company shall be appointed at the annual meeting of shareholders by unanimous vote (or by a special majority large enough to require the approval of all shareholders).*

MARKETING ARRANGEMENTS

In any free-enterprise economy, the ultimate success of the Joint Company will depend on its ability to sell its products and obtain a reasonable profit on its sales. Some of the marketing problems that may confront joint-venture partners and some of the possible means of dealing with them are discussed below. (References to "the products" imply in all cases the products which the Joint Company has been formed to manufacture and sell.)

Marketing area

Unless the basis of the Joint Venture is to limit its marketing activities to the host country or other specified area, it should not be prevented from gaining access to as large a market area as it is capable of supplying, consistent with the existing obligations and commitments of the foreign partner. A common complaint of local partners of joint ventures is that the foreign partner wants the Joint Company to supply only the market of the host country and perhaps those of a few neighbouring soft-currency countries, while it services other profitable world markets from its wholly-owned facilities located elsewhere. On the other hand, it would be unreasonable to expect an international company to compete with itself through its overseas affiliates.

One of the top economic priorities of most developing countries is to establish export industries to earn foreign exchange. Accordingly, the Joint Company may aim at obtaining reasonable access to foreign markets, particularly in hard-currency countries.

Three market regions the Joint Company may wish to supply are:

(a) The host country;

(b) The country of the foreign partner (particularly in the case of so-called "subcontracting" or "throughput" joint ventures);

(c) Other designated countries.

The principal non-economic factor preventing the Joint Company from being able to exploit all markets of the world is that the licensing agreements obtained from the foreign partner and elsewhere often impose a territorial restriction on the sale of the licensed products. The foreign partner will be able to grant licences for such areas to the Joint Company only to the extent that it has not entered into binding agreements with other unrelated persons giving them the right to exploit the same industrial property in other countries.

Accordingly, as a prerequisite to entering negotiations, the host country partner may wish to obtain the following information from the foreign partner or the licensor:

(a) The industrial property rights affecting the products, including the patents, trade marks and trade names owned by or licensed to the foreign partner;

(b) Relevant licence and sublicences granted by the foreign partner or licensor to other parties, indicating:

(i) Date of expiry of each;

(ii) Geographical area covered;

(iii) Conditions under which each may be terminated by the foreign partner or licensor;

(iv) Products and industrial property included in each such licence or sublicence;

(v) Royalties payable under each.

Having obtained as much of the above and other information as is possible, the local partner is in a better position to bargain for the largest practicable market area for the Joint Company.

When licences have been granted by the foreign partner for other market regions which the Joint Company could advantageously exploit, a provision may be inserted in the agreement stipulating that upon the expiry or termination of such licences, whichever is earlier, those market regions will be opened to the Joint Company. Since licence agreements are frequently of not more than ten years' duration, such a provision would enable the Joint Company to exploit new market regions from time to time and as it becomes increasingly capable of doing so.

A further point for the local partner to consider is the possible violation by the foreign partner or licensor of antitrust laws through territorial restrictions on marketing areas. American, Canadian and European companies will be particularly aware of possible violations. Antitrust legislation is a topic too vast for more than a mere mention in this study. If the foreign partner or licensor is in violation of antitrust laws in his existing international marketing and business arrangements, this fact may encourage the foreign partner to transfer some of those operations to the Joint Company.

Marketing aids

Provision should be made for the Joint Company to obtain all the data and information available to the foreign partner for the promotion, advertising and sale of its products. The cost of having promotional aids and advertising programmes prepared may be very high. The Joint Company should therefore try to obtain as many of such materials as possible from the foreign partner.

The partners may agree that the cost to the Joint Company of such materials should be only the marginal cost of printing and transportation of the materials acquired without any contribution to the overhead costs of creation already incurred by the foreign partner. Provision should also be made for the right to use all new aids developed during the term of the joint-venture agreement.

SPECIMEN CLAUSE

Foreign shall supply to the Joint Company at cost without any charge for creative work all advertising and marketing aids which it now has or shall acquire during the term of this Agreement and which relate to the products produced or sold by the Joint Company. More specifically, but without limiting the generality of the foregoing, such advertising and marketing aids shall include brochures, pamphlets, catalogue sheets, labels, boxes, cartons, packaging, diagrams, manuals, designs, pictures, descriptions, instructions, films, scripts, recordings, colour schemes and other data designed to explain, assist or promote the sale, distribution, use and servicing of the said products.

Marketing organization

In many cases it is the marketing expertise and access to world markets of the foreign partner which constitute his major contribution to the joint venture. In such cases provision should be made in the joint-venture agreement for the Joint Company to enjoy the advantages of the Foreign Company's world-wide marketing organization, including selling, advertising, merchandizing and after-sales servicing.

In some cases it is advantageous to arrange for the Foreign Company and/or its overseas sales affiliates to purchase products from the Joint Company for distribution in export markets. Care must be then taken to negotiate fair inter-company prices.

Trade marks and trade names

Where the products to be manufactured by the Joint Company have achieved market recognition under certain trade marks and trade names, the Joint Company may wish to use those trade marks and trade names upon the best possible terms. Depending on the goodwill already established for the particular trade names and trade marks, such industrial property rights are often important factors in ensuring both local and foreign market penetration for the Joint Company's products. Such goodwill may be a result of the foreign partner's marketing policies in respect of the products licensed to the Joint Company.

Because the foreign partner will participate in the profits of the Joint Company, he should co-operate in making such trade marks and trade names available to the Joint Company without charge. *A fortiori,* where products of the Joint Company are already subject to payment of patent royalities to the foreign partner, no additional royalties should be paid for the use of the trade marks or names under which they are sold.

In addition, the use of such trade marks and trade names by the Joint Company may also serve to publicize them further and increase the goodwill attached to their ownership by the foreign partner. Where trade marks and trade names are purchased outright by, rather than licensed to, the Joint Company, the participation of the foreign partner in the profits of the Joint Company should be stressed as the most important factor in ensuring that their cost, if any, to the Joint Company is as low as possible.

Because of the importance of trade marks and trade names to the success of a joint venture and because they will usually be obtained by licence from the foreign partner, some of the provisions of a typical licence agreement for trade marks and trade names are discussed below.

Typical provisions of trade mark licensing agreements

Parties

The licensee will be the Joint Company and the licensor will be the foreign partner, or some other third party.

Recitals

Recitals usually mention that the licensor has the right to license certain industrial property rights and that the licensee wishes to use them in respect of certain specified products.

Definitions

It is common to define items such as: *(a)* the territory for which the rights are granted; and *(b)* the products on which the names and marks are to be used, i.e. the authorized products.

Grant of licence

The Joint Company will wish to ensure that the licence granted is an exclusive one for the territory. In deciding upon the territory in which the Joint Company is to obtain the right to use the trade marks and trade names, the same considerations apply as with respect to the territory in which it obtains the right to manufacture and sell the authorized products from the foreign partner. Generally, the Joint Company will wish to obtain as large a territory as practicable in the circumstances.

In some developing countries, it may be national policy to prohibit the use of foreign trade names and trade marks in competition with locally produced goods. Where this is the case, the partners will have to agree on new names and marks for the host country, but they will generally stipulate that products exported from the host country are to bear the international trade marks and names with their existing goodwill.

SPECIMEN CLAUSES

1. *Foreign hereby grants to the Joint Company the right during the continuance and subject to the provisions of this Agreement to use each and every of the trade marks and trade names upon or in connexion with the authorized products manufactured and/or assembled by or on behalf of the Joint Company within the territory and which comply with the relative standards, and the Joint Company agrees that it will use the trade marks and trade names upon or in connexion with all authorized products so manufactured and/or assembled.*

2. *The right of the Joint Company to use the trade marks and trade names as aforesaid is an exclusive right for the whole of the territory.*

Registration

To protect against unauthorized use of the trade marks and names by third parties, registration is usually required.

SPECIMEN CLAUSE

Prior to the use by the Joint Company of any of the trade marks or trade names, Foreign and the Joint Company shall take all steps necessary to ensure that the said trade marks and trade names in this Agreement, where necessary, are registered in all of the appropriate jurisdictions within the territory and take all such other necessary steps as are required to prevent the unauthorized use by other parties of the said trade marks and trade names. Foreign and the Joint Company shall from time to time execute and do all such documents, acts and things as may be required to ensure that the Joint Company's use of the trade marks and trade names is in all respects in accordance with the law and practice of the various jurisdictions within the territory and is not injurious to Foreign's rights as proprietor of the trade marks and trade names.

Termination

The grant of licence may be made: *(a)* in perpetuity; *(b)* for a fixed term in years; *(c)* for the duration of the joint venture; or *(d)* for the duration of the patent licence agreement.

In so far as the trade mark and trade name rights are worth while for the Joint Company to enjoy, it will be advantageous for the grant to be for as long a period as possible.

When the foreign partner is the licensor, he may wish to tie the grant to the duration of his participation in the joint venture. In the case of international trade marks which are being used by the foreign partner and his affiliates independently of the joint venture such a limitation is only reasonable. In the case of trade marks peculiar to the joint venture, this position could work a hardship on the Joint Company. If the foreign partner decides to withdraw after effort and money have been expended to promote the products bearing the mark and name, withdrawal would mean a loss of all such goodwill. Accordingly, the Joint Company will generally be in a stronger position if the termination is independent of the duration of the foreign licensor's equity participation in the joint venture.

As mentioned earlier, it is not unreasonable that as long as the foreign licensor is a partner in the Joint Company no royalties should be paid for the use of its trade marks and trade names. If such rights are to continue after withdrawal by the foreign partner, however, it is reasonable that royalties should be paid, and in this case, the foreign partner should not object to granting such rights beyond the period of his participation in the joint venture.

If the alternative to tying the licence to the equity participation of the foreign partner is a fixed-term agreement, the Joint Company will still suffer from the loss of goodwill when it has to give up use of the trade marks and trade names. The solution may be, therefore, for the Joint Company to become the owner rather than licensee of the trade marks and trade names it uses, so long as these are not international trade marks or names.

This may be achieved by either:

(a) Assignment from the foreign partner. An arrangement may be made whereby trade marks and trade names are purchased by the Joint Company from the foreign partner. They may constitute part of the foreign partner's contribution to capital.

(b) Adoption of new marks and names. If the goodwill to be derived from use of the foreign partner's trade marks and trade names is not significant or may not be necessary to assist in either domestic or foreign sales, the Joint Company may seriously consider establishing its own marks and names so that all goodwill generated will accrue to it and will not be lost by expiry of time, withdrawal of the foreign partner etc.

SPECIMEN CLAUSES

1. *The term of this Agreement shall be____ years, provided that notice of its intention not to renew this Agreement be sent by Foreign to the Joint Company at least six months prior to the termination hereof. In the event that no such notice shall have been given, this Agreement shall continue for a further____ years, and thereafter until six months' notice shall have been received by the Joint Company.*
2. *Notwithstanding the above provision, this Agreement shall terminate if the Joint Company shall become dissolved or enter into liquidation (whether voluntary or compulsory) or become subject to or submit to any law for the relief of insolvent debtors or if a receiver shall be appointed in respect of any of its assets or if any execution shall issue against the Joint Company.*

Sublicensing

The Joint Company's operations will generally be more flexible if it has the right to assign its licence rights and sublicence their use to others.

SPECIMEN CLAUSE

The Joint Company shall have the right to assign the benefits to this Agreement, and to sublicence the rights to the trade names and trade marks, to such other parties and upon such terms and conditions as it shall in its absolute discretion determine, provided, however, that it remains responsible to Foreign for its obligations hereunder and provided that such assignment or sublicence shall apply only to the designated territory.

Terms for the protection of the foreign licensor

(a) Use of trade marks and trade names

It is customary for the foreign licensor to insist on clauses inserted in the licence agreement requiring the licensee to undertake:

(i) To comply with the legal requirements for affixing marks and names to the products;

(ii) To notify the licensor of its manner of using the names and marks;
(iii) To use only the authorized marks and names in association with the products;
(iv) Not to use the names and marks for any unauthorized products;
(v) Not to violate the territorial restriction placed on the use of the marks and names.

(b) Inspection

To ensure that the goodwill associated with his marks and names is maintained, the licensor will generally require the right to:

(i) Inspect the products bearing the names and marks;
(ii) Test the products to ensure quality;
(iii) Investigate the marketing techniques relating to products bearing the marks and names;
(iv) Prohibit the sale of any non-complying products.

(c) Ownership

The licensor may require the licensee to affirm that:

(i) The use of the marks and names by the licensee does not derogate from the ownership thereof by the licensor;
(ii) The licensee will not deny or question the validity of the registrations of the marks or names.

(d) Infringements

In case of unauthorized use of the marks or names, the licensor will often stipulate that:

(i) The licensor will have the exclusive right to take action against an infringer;
(ii) The licensee will assist in bringing any such action;
(iii) The licensee will notify the licensor of any suspected infringements.

(e) Rights after termination

The licensor will often insist that clauses in respect of some or all of the following conditions come into effect upon termination of the licence agreement:

(i) The licensee will assist in cancelling any registrations there may be of the licence agreement;
(ii) The licensee will discontinue use of the marks and names;
(iii) The licensee will either resell to the licensor at cost, or else destroy, at the option of the licensor, all advertising, stationery, containers etc. bearing the marks and names;
(iv) The licensee will permit the licensor to purchase all inventories bearing the marks and names; the cost thereof should be the fair market value.

Chapter 6

PATENT LICENSING ARRANGEMENTS

For an industry in a developing country to manufacture a patented product, it may have to be either the owner or the licensee of the relevant patent or patents. It is unusual for an industry in a developing country to own any patents, but it is almost universal practice for manufacturing joint ventures in developing countries to be licensees of foreign patents.

Patent licence agreements generally take a standard form, except for the provision relating to the royalties payable and the related technical information and know-how to be supplied. Some of the standard terms appearing in a patent licence agreement where only a relatively small quantity of know-how is required by the Joint Company are outlined below, and the ones relating to royalties are discussed in detail. Related provisions with respect to technical information and know-how are discussed separately in chapter 7. Throughout the discussion, it is assumed that the foreign partner in the joint venture is also the licensor of the patents; but when the licensor is an independent party, many of the same considerations will also be valid.

Some possible terms for a patent licence agreement, excluding royalties

Recitals

The recitals generally state that the licensor (here assumed to be the foreign partner) is engaged ithe manufacture of certain products pursuant to the patents of which it is the owner (or licensee) and that the licensee (in this case the Joint Company, which may also be a sublicensee) wishes to manufacture the same products using the same patents.

Definitions

It is common to define the following terms:

(a) Licensed products, meaning the products the licensee is authorized to manufacture. The Joint Company should ensure that as wide a range of products as possible are included, and that any new products based on the patents or any improvements developed by the licensor are also included.

(b) Territory, meaning the geographical area in which the licensee is entitled to manufacture and sell the licensed products. As has been previously discussed, the Joint Company should generally attempt to secure as large a territory as possible.

(c) Technical information, including an enumeration of all the possible types of printed matter and data that may be necessary for the licensee to produce the licensed products.

Grant of licence

In this clause the licence is granted to the licensee for the term of the agreement, and the licensee is authorized to manufacture and sell the licensed products within the territory. The licensee should attempt to obtain an exclusive licence for the territory.

Quality control

The licensee will generally have to guarantee to maintain certain standards of quality required by the licensor, and the licensor will be given the right to inspect the licensed products to ensure such standards.

Infringement actions

The licensor will generally require a clause in the licence agreement stating that the licensor does not warrant that the patents do not infringe industrial property rights of third parties. The licensee should attempt to have inserted a clause that in the event of infringement, the licensor will indemnify and save the licensee harmless, meaning that all the financial losses suffered therefrom by the licensee may be recouped from the licensor and the licensor will be responsible for defending any action brought.

Sales to licensee

It is common for the licensee to require a clause that if it needs any materials or supplies, the licensor will use its best efforts to have them supplied by itself, by its affiliates or by other parties.

Assignments and sublicences

To permit the fullest possible exploitation of the patent rights, the licensee should attempt to secure the rights to assign the agreement and to sublicense other producers throughout the territory.

Termination

The licensee may wish to terminate the obligation to pay royalties after either a definite period or the expiration of the patents being licensed. If so, it may wish to obtain an option to continue the licence until the expiration of the last patent or renewal thereof, or any time earlier by giving, for example, one year's notice.

Related know-how

Chapter 7 outlines in considerable detail other provisions in respect of the supply by the licensor of technical data, information, assistance and know-how related to the patents licensed.

The provisions set forth below are not detailed, but may suffice where the Joint Company has existing production facilities and the know-how it requires is not extensive.

SPECIMEN CLAUSES

1. *The Licensor shall make available to the Licensee without charge and as required by the Licensee all such technical data and information as shall be necessary for the Licensee to manufacture, sell and service the licensed products and all products related thereto.*
2. *If the Licensee shall desire technical assistance in connexion with the manufacture, sale, application or servicing of the licensed products and all products related thereto, the Licensor shall make available to the Licensee the services of trained personnel for and during such periods as the Licensee shall reasonably require.*
3. *Representatives of the Licensor and the Licensee shall from time to time consult with each other regarding research, production, sales, servicing, advertising and promotion pertaining to the manufacture and sale of the licensed products, and including all developments and improvements in respect thereof, and the Licensor shall do all such things as shall be necessary to supply all the technical data and information and technical assistance in respect thereof as the Licensee shall request in accordance with the terms of the two preceding paragraphs.*

Royalties

Types of royalties

Royalties, or fees paid for the use of industrial property, may be in the form of *(a)* lump-sum payments or *(b)* payments on a continuing basis. A lump-sum royalty is usually a payment to reimburse the foreign partner before any use is made of the industrial property, whereas continuing royalties depend upon the extent of the use made of the industrial property.

Computation of royalties

(a) Lump-sum royalties

Some possible considerations for determining or computing lump-sum royalties are as follows:

(i) The costs to the foreign partner of transferring the industrial property, including the related know-how, technical information and technical assistance to the Joint Company;

(ii) The amount the foreign partner feels he should demand as a token of the good faith of the licensee;

(iii) The goodwill which the foreign partner feels may be attached to the right to use the industrial property in the particular region.

If the foreign licensor is also an equity partner in the Joint Company, the reasons for an initial lump-sum royalty payment are substantially weakened; as an equity owner, the foreign partner will participate in the goodwill accruing to the Joint Company, will be in a position to assure the Joint Company's good faith, and will profit in proportion to his shareholdings to the extent that the Joint Company does not have to make a lump-sum royalty payment. Accordingly, it may be best not to pay a lump-sum royalty to the foreign licensor, but if one is necessary, it should be kept low, and may be paid for in fully paid shares rather than in cash. Generally, however, lump-sum royalties are not to be recommended.

(b) Continuing royalties

Some ways in which continuing royalties may be computed or expressed are as follows:

(i) As a fixed amount for each unit produced through use of the industrial property;
(ii) As a fixed amount for each unit sold;
(iii) According to the gross selling price of each unit;
(iv) According to the net selling price of each unit;
(v) As differential royalties for units sold abroad and units sold in the host country;
(vi) As minimum royalty requirements, often based as a rule of thumb, on half of the royalties which would otherwise derive from realization of the market projections;
(vii) As differential royalties based on the number of units produced or sold, usually varying inversely with the quantity;
(viii) As net royalties, after deduction of all taxes payable by either or both the Foreign and the Joint Company to the host country in respect thereof.

It is impossible to specify which base or bases for computing a continuing royalty will be best for industrial joint ventures in developing countries. Some points to be considered are discussed below.

A royalty based on the net selling price is probably better in most instances than one based on either production or the gross selling price because it encourages the foreign partner to do everything possible to maximize the selling profits of the Joint Company and does not burden the Joint Company with payments when goods are produced but not sold.

When one aim of the Joint Company is to encourage exports from the host country, and the foreign partner is either making export markets available or is assisting in the export sales or doing both, a strong bargaining point for the Joint Company may be to pay differential royalties for export sales. Higher royalties paid on the net selling price of exported products, as opposed to products sold in the market of the host country, may encourage more active co-operation by the foreign partner-licensor in developing foreign markets and in securing the rights initially for the Joint Company to exploit such markets.

Minimum royalty requirements may provide a certain measure of security to the foreign partner and prevent the Joint Company from "sitting on the patent". As an equity participant in the joint venture, however, nothing should be done which would enable the foreign partner to profit unreasonably at the expense of the Joint Company. Rather, the remuneration the foreign partner receives should be a direct

reflection of the Joint Company's success, for which the foreign partner must be at least partly responsible, and minimum royalties are not, therefore, recommended.

Licensing agreements often provide for progressively decreasing royalties based on the number of units produced or sold: the greater the number, the smaller the royalty. This practice may not be ideal for joint ventures where the foreign partner is the licensor, in so far as it may not encourage maximum efforts to expand after a certain sales or production level has been reached. In addition, it may have the effect of ensuring a minimum royalty.

Provision for net royalty payments, "net" of all host country taxes, may sometimes be required by the foreign licensor for tax reasons. For example, if a net royalty of $1.00 is stipulated and the host country imposes a 15 per cent withholding tax on all royalty payments to foreigners or non-residents, the Joint Company would have to pay total royalties of approximately $1.18 to achieve the net royalty of $1.00. Assuming that the foreign licensor is taxed at 50 per cent on his royalty income in his own country but can take advantage of a foreign tax credit provision (which is an almost universal practice in developed countries), he would receive 59 cents net after all taxes, with 18 cents in taxes having been paid to the host country and 41 cents to his own country. On the other hand, if a "gross" royalty rather than a "net" royalty of $1.00 is specified, the foreign partner will receive net after all taxes 50 cents, with 15 cents in taxes having been paid to the host country and 35 cents to his own.

The effect of such a provision on the local partner's net earnings from the Joint Company should be carefully calculated and compared with the advantage to be derived by the foreign partner.

Payment of royalties

Three issues arising in respect of the payment of royalties are: the currency in which the royalties are to be paid; whether they will be paid in the form of fully paid shares or assets of the Joint Company; and the place where they are to be paid.

Currency

The royalties may be paid in the currency of the host country, that of the licensor's home country or that of some third country. If the Joint Company sells its products abroad, it may be possible to pay the royalties out of the proceeds of the foreign sales. This approach has the advantage of providing an incentive to the foreign partner to aid the Joint Company to increase its export sales–i.e. if no goods are sold abroad the foreign partner will receive no royalties. On the other hand, it has the disadvantage of reducing the over-all earnings in foreign exchange of the Joint Company and the host country. It may, therefore, be more advantageous from the point of view of the host country if the royalty payments are made in the currency of the host country.

On the other hand, the foreign partner will generally want payment to be made in the currency of his own country or else in some other hard currency in order to hedge against devaluation and inflation risks in the host country. If the foreign partner, therefore, is not willing to accept royalty payments in the currency of the host country, it is recommended that payments be made out of the currency earned from export sales in each market area. By this means, royalties will be paid in both

soft and hard currencies. If the foreign partner insists on a payment in any specified currency, the Joint Company must be put in a position to earn the necessary currency through export sales.

Assets or shares

When initial lump-sum royalties are to be paid to the foreign partner, payment is often made in fully paid shares of the Joint Company, and it is thereby possible to save scarce funds. This approach may also be adopted for payment of continuing royalties.

A further possibility is to provide for the payment of royalties with inventory of the Joint Company. In this way, a certain limited market is created for the products of the Joint Company, and the foreign partner can either keep such products or resell them. This approach, if feasible, may be the best one for joint ventures in developing countries because it creates a market for a few of the products of the Joint Company and obviates the outlay of either foreign or local currency. This approach may also present advantages to the foreign partner. It may mean that the foreign partner will not have to pay the host country's withholding taxes on royalty payments. Nor will the foreign partner be likely to experience any tax disadvantages in the home country or elsewhere because net resale proceeds after deduction of import duties, if any, and transport charges will generally be no higher than the tax on income from royalties.

Place

Often the place of payment of royalties will depend on the type of payment. It will probably be easiest for the Joint Company to make payment in the host country, but if royalties are paid out of proceeds from exports and the foreign partner is conducting the international selling operations, royalties may be deducted from payments received in each of the foreign market areas.

SPECIMEN ROYALTY CLAUSES

1. *In consideration of the granting of the licence contained in this Agreement, the Joint Company hereby agrees to pay to Foreign within 60 days following the end of each calendar year royalties equal to____per cent of the net sales prices of all Licensed Products manufactured and sold by the Joint Company during such year.*

2. *Licensed Products sold by the Joint Company pursuant to the licence herein granted shall be deemed to have been sold when paid for.*

3. *If the Licensed Products are returned or allowances made thereon after the royalty thereon shall have been paid, the Joint Company shall be entitled to take appropriate credit for such overpayment against royalties thereafter accruing.*

4. *Each payment to be made hereunder shall be made in (currency); or in the respective currencies in which sales of the Licensed Products are invoiced by the Joint Company at such place as Foreign may designate.*

5. *In lieu of payments as provided for in Clause 4 above, the Joint Company shall have the option of satisfying such obligation to pay by either:*

   (a) Issuing fully paid-up shares in the capital stock of the Joint Company to Foreign, in which case the shares shall be valued at the higher of either their book value as determined by the auditors of the Joint Company or at their par value, and shall be issued in sufficient multiples so that their aggregate value satisfies but does not surpass the payments due hereunder, with any difference being paid in (currency);

   or

   (b) By delivering to Foreign f.o.b. (nearest point to production facilities in host country) a sufficient quantity of the licensed products set forth in Schedule A hereto annexed so as to satisfy but not surpass the aggregate payments due hereunder, with any difference being paid in (currency). The value of said licensed products for the purposes of this clause shall be the unit cost of production thereof as determined by the auditors of the Joint Company, plus ____ per cent.

6. *Any taxes, duties or imposts other than income or profits taxes assessed or imposed upon the sums due hereunder to Foreign pursuant to this Agreement, shall be borne and discharged by Foreign, and if so required by law, the Joint Company shall deduct them from any payments to be made to Foreign hereunder.*

7. *The Joint Company agrees to use its best efforts to obtain any necessary approval for this Agreement by the authorities of (host country) or of any other country, countries or groups of countries in the territory, and to obtain the consent of any such authorities to the remittance of payments to Foreign under this Agreement in the event that such consent shall be necessary.*

Chapter 7

TECHNICAL INFORMATION, TECHNICAL ASSISTANCE AND KNOW-HOW

While a patent licence ensures the right to produce a certain product, it does not necessarily provide the licensee with the requisite know-how to produce it. Accordingly, the patent licence must impose on the licensor the obligation to supply the Joint Company with all the technical data, information, assistance and know-how necessary to use the patent rights to produce the required product.

It is common practice for patent licence agreements to contain provisions for the supply of this related information and know-how. When the licensee possesses a certain degree of manufacturing know-how, the technical assistance required may be very limited. Manufacturing industries in developing countries, however, may require a great deal, and the scope of legal provisions may have to be very broad, going even so far as to provide know-how for construction of the necessary facilities for production.

When the know-how required is not very extensive, it is common to include all the know-how provisions in the patent licence agreement, but when more know-how is required it may be better legal practice to draft separate technical assistance and know-how agreements. Separate agreements are also generally drawn up for all items not directly related to actual use of the patent rights, such as construction of the production facilities, the supply of technical advisers and assistance in training.

Several specific areas in which the Joint Company may require technical information, technical assistance and know-how are outlined below.

Planning of facilities

The Joint Company may obtain plans and specifications for construction of the plant and production facilities in several ways. The foreign partner may possess plans for the construction and layout of the plant and production facilities required by the Joint Company, or it may have an engineering and architectural staff capable of producing them. It may, however, be necessary for the Joint Company, with the assistance of the foreign partner, to commission an independent firm of consulting engineers to design the production facilities. A further possibility is for the foreign partner to undertake to obtain the plans and specifications from independent sources and make them available to the Joint Company.

Some of the main concerns of the Joint Company at this stage may be:

(a) To obtain the requisite plans at the lowest cost;

(b) To ensure that the facilities are adequate to satisfy production requirements;

(c) To ensure that the facilities are capable of expansion as sales potential increases;

(d) To ensure that the facilities are of the latest, most modern and most economical design and construction.

One of the best approaches for the Joint Company may be to require the foreign partner to provide all the plans etc., permitting him to obtain them from whatever sources he may choose, including plans he may have on hand. Consulting engineers may be required to adapt existing plans to the new site etc., but this will be less costly than starting afresh, and such savings can be passed on to the Joint Company. These savings may be reflected in a lower price or in lower royalties paid by the Joint Company. The Joint Company will be able to protect all its previously cited interests through contractual undertakings by the foreign partner.

SPECIMEN CLAUSES

1. *Foreign shall furnish to the Joint Company detailed plans, specifications, blueprints and other data and information sufficient to enable a qualified contractor or contractors to construct production facilities at (address of site in host country) capable of producing (quantity) per year of (list products), which said production facilities shall be capable of being altered, added to or expanded in an economical fashion so as to increase the production of the above said products or to adapt the facilities for the production of other related or similar products as the business exigencies of the Joint Company may from time to time require, and shall be of the latest, most modern and most economical design, and shall be capable of producing the said products in the most efficient and economical fashion.*

2. *Foreign hereby warrants and guarantees that the said production facilities shall satisfy all the above requirements.*

Construction of facilities

Efficient means of constructing production facilities that will at the same time maximize the benefits to the host country should be determined. This is a matter for agreement between the partners prior to the production of the Joint Company. Construction will usually involve two main phases: first, construction of the plant; and, second, purchase, construction, assembly and installation of the required machinery and equipment. These two phases may be undertaken either separately or together; when undertaken separately, the responsibilities for each phase may be assumed by either the same or different parties.

When the plant itself is of standard specifications, it may be practicable for the local partner, because of his knowledge of local conditions, contractors and personnel, to assume a major role in having it constructed according to the

specifications agreed upon by the foreign partner or consulting engineer responsible for their design. The greater expertise needed in respect of the machinery and equipment may require the foreign partner to assume the major role in this area. In both cases, however, the expertise of both partners will be of much benefit, and their co-operation should be ensured.

In all aspects of construction, the host country will benefit from obtaining locally as much of the materials and personnel as possible. In addition, the Joint Company will benefit most by this approach because of the cheaper costs and the convenience of having local people who can do follow-up and repair work.

With his knowledge of local conditions, the local partner will be in a good position to assist in obtaining a reliable contractor and subcontractors, as well as in carrying on liaison work with them to help overcome problems as they arise. It may, therefore, be advisable to stipulate that the local partner must either approve the contractor and/or subcontractors, or at least that it is his obligation to assist in their selection. A provision may also be inserted that, whenever possible, contractors, subcontractors and workers are to be from the host country, and that all materials—price and quality being equal—should be obtained locally.

Another problem is to decide to whom the contractors should be legally responsible for construction according to the specifications. They may be primarily responsible to the Joint Company, to the foreign partner, or to the consulting engineer. In the last two instances, such parties may in turn be made responsible to the Joint Company. It is difficult to suggest that any one approach may be better than another; but if the contractor or consulting engineer is responsible to the foreign partner and the foreign partner is responsible in turn to the Joint Company, the foreign partner with his expertise will be in a good position to ensure that the production facilities conform to the requirements and the Joint Company will have ready recourse against the foreign partner to ensure compliance.

One way to provide for construction of the production facilities is through a "turn-key" contract, where the production facilities are turned over to the Joint Company in complete working order. Another is for the Joint Company to undertake the construction through the hiring of the contractors and subcontractors on its own, and to satisfy itself, with the assistance of outside experts and/or experts from the foreign partner, that the facilities satisfy the requisite standards.

Regardless of which approach is adopted, it may be desirable to make the foreign partner legally responsible to the Joint Company for ensuring the completion of the production facilities according to the requisite standards and specifications, and the foreign partner can then be left relatively free to enter into what guarantees it may wish with the contractors and/or consulting engineers.

SPECIMEN CLAUSES

With respect to the construction of the plant and the production facilities, Foreign and Local hereby agree as follows:

1. *Foreign shall assume full responsibility to the Joint Company for ensuring that the plant and production facilities conform to the required specifications and are capable of producing the required products.*

2. *In the construction of the plant and production facilities, Foreign and Local agree to use their best efforts to ensure that as much of the materials, equipment and machinery as possible are obtained in (host country), provided there is no sacrifice in quality and the costs thereof are not greater than the cost of obtaining them from elsewhere, and to ensure that as many of the contractors, subcontractors, workers and other personnel engaged therein are nationals or residents of (host country).*

Supply of machinery and equipment

The Joint Company should ensure that all machinery and equipment supplied to it, whether as a contribution to capital or otherwise, or whether by a partner or an independent party, adequately meet its requirements. The machinery and equipment should be:

(a) Capable of producing the specified products;

(b) Of the latest design;

(c) Capable of satisfactory operation without abnormal maintenance;

(d) Compatible with existing machinery and with machinery that may be added later;

(e) In accordance with the highest specifications of quality production;

(f) Reasonably priced in the circumstances.

In addition, replacement parts and service facilities should be readily available.

The Joint Company may be able to protect itself from acquiring inadequate or unsuitable machinery and equipment in several ways. It may:

(a) Obtain a guarantee and warranty from the supplier that the machinery and equipment will meet specified qualitative and quantitative production standards, in default of which the supplier shall be liable for damages to the Joint Company.

(b) Require certification from independent consultants as to the fitness of the machinery and equipment for the job required.

(c) Purchase all machinery through public tenders upon specifications prepared by independent consultants, including warranties and guarantees and/or a certification of fitness as above; this approach may be helpful when the foreign partner wishes to supply machinery, as it provides an outside standard for judging its adequacy.

(d) Obtain independent assurance from the manufacturers that the equipment and machinery is not obsolete; that they will not be obsolete within the immediate future, barring a major technological breakthrough; that they are compatible with existing machinery and with machinery the manufacturer will be producing in the future, so that the introduction of new machinery and equipment will not necessitate a scrapping of the old; and that replacement parts are readily available.

(e) Apply to international organizations such as UNIDO for assistance in assessing the tender bids or in evaluating the type and quality of machinery to be supplied.

SPECIMEN CLAUSES

1. *Foreign hereby undertakes to warrant and guarantee to the Joint Company that the machinery and equipment are capable of producing the products in the quantities and according to the required specifications, which said machinery and equipment, quantities and specifications are set forth in Schedule_____ annexed hereto; are of the latest design and incorporate all workable improvements; shall be capable of satisfactory operation with normal maintenance as outlined in the manufacturer's specifications; will be compatible with existing machinery owned by the Joint Company and with new machinery it may acquire; and that replacement parts are readily available therefor.*

2. *Foreign hereby undertakes to guarantee to the Joint Company that independent of any guarantees or warrantees provided by manufacturers, sellers, consultants or any other persons whomsoever, the said machinery and equipment shall function effectively and produce the required products according to the qualitative and quantitative specifications outlined for a period of___ _years.*

3. *In the event of any failure to satisfy the above requirements, Foreign shall be liable to the Joint Company for damages for all costs required to rectify the situation and for all damages occasioned by the loss of production, including all costs of shutdown and start-up.*

SPECIMEN ALTERNATIVE SHORT CLAUSES

Foreign shall furnish to the Joint Company:

1. *Advice in connexion with all phases of the design, layout and construction of the production facilities;*

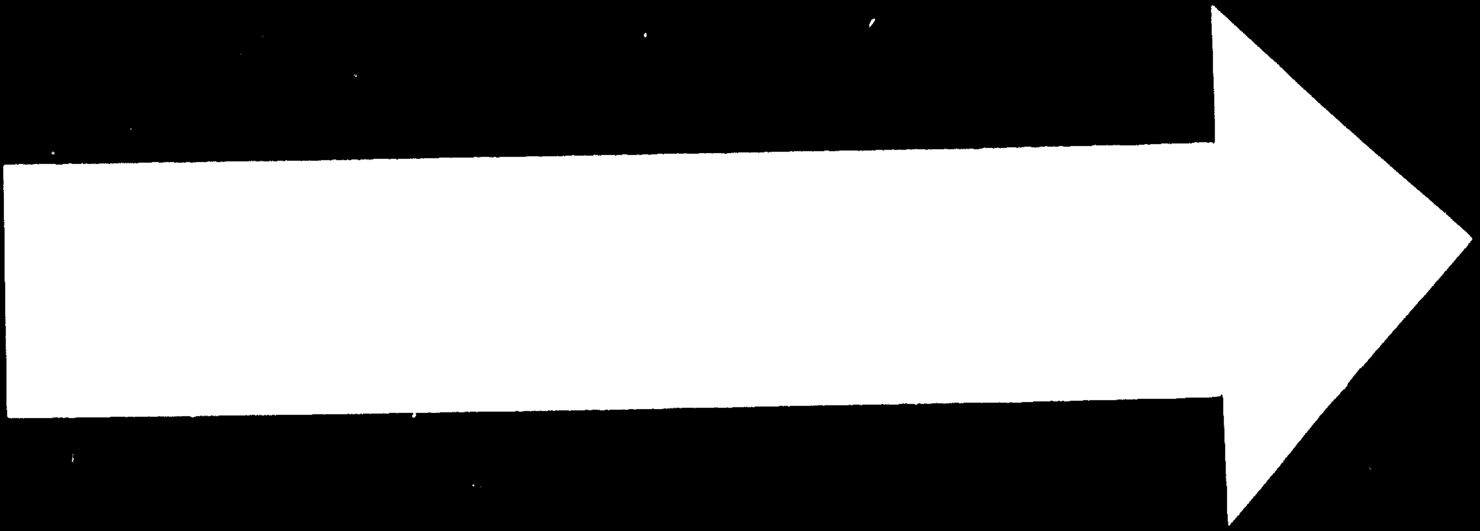
2. *Advice with respect to the specifications of equipment, placement of orders, and the awarding of contracts;*

3. *And shall review all plans, layouts, designs, bids and contracts for the supply of equipment and machinery.*

Installation of machinery

SPECIMEN CLAUSE

Foreign shall furnish to the Joint Company all the necessary technical assistance to assemble and install the equipment and machinery in the plant so that it will function in the manner required in the specifications.



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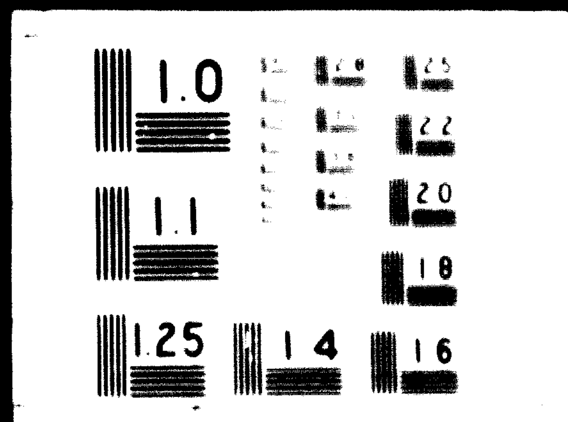


Maintenance of facilities

SPECIMEN CLAUSE

Foreign shall furnish to the Joint Company all the technical data, information and assistance necessary to ensure the effective operation and maintenance of the machinery and equipment, including:

(a) A list of recommended plant spares.

(b) Lubrication and maintenance manuals.

(c) Detailed operating instructions.

(d) Detailed manuals indicating the construction and assembly of each model and type of machinery and equipment.

(e) Instructions regarding start up and shutdown.

Operation of facilities

SPECIMEN CLAUSE

Foreign shall furnish to the Joint Company technical assistance and advice on all aspects of plant operations including, but without limiting the generality of the foregoing:

(a) Scheduling, material specifications and ordering, and production techniques relating to the manufacture of the products.

(b) Quality control and production planning.

(c) Methods, studies and other industrial engineering activities in connexion with the organization, planning, training of personnel, and development of operating practices and procedures to obtain the most efficient use of the production facilities.

(d) Recommended safety procedures.

Testing of facilities and products

SPECIMEN CLAUSES

1. *The Joint Company shall not be required to accept the plant or production facilities until such time as it shall be wholly satisfied that the said production facilities are capable of producing the required products in the required quantities.*

2. *Accordingly, before such acceptance, representative samples of each type of product to be produced by the Joint Company shall be sent to (name of independent testing agency or firm, or to Foreign's main production plant) for testing to ensure their compliance with the required standards and specifications and that they have been constructed in a good and workmanlike manner, and the Joint Company shall have been furnished with a guarantee and warranty of the satisfaction of such conditions.*

Research and development

Because it is most unlikely that the Joint Company will have its own research and development facilities, it should be able to take advantage of all new developments available to the foreign partner.

SPECIMEN CLAUSE

Foreign shall during the term of this Agreement provide to the Joint Company all technical information and assistance as shall be necessary to keep the Joint Company aware of, current with and able effectively to use the latest developments in technology applicable or relating to the manufacture, sale or use of the products to be produced by the Joint Company.

Training obligations

It must be decided what the obligations of the foreign partner shall be with respect to training the personnel of the Joint Company in the operation of the production facilities. Most joint-venture agreements provide for training of the employees of the Joint Company by representatives of the foreign partner both in the host country and at one or some of the foreign partner's plants abroad. The Joint Company will wish to obtain the best possible training for its employees at the lowest cost. Generally, it will be less expensive to provide on-the-job training by employees or representatives of the foreign partner who serve as employees of the Joint Company. This approach may also foster greater co-operation than would be achieved by providing on-the-job training by outsiders. While the cost of sending employees to the foreign partner's plant for training and instruction may be very high, it is usually found to be worth while for a limited number of key technical employees, including foremen, supervisors and technical officers.

The need for training will generally be greatest before the start-up of production, and the Joint Company should ensure that the foreign partner will make sufficient personnel available for training during this crucial period. It may also be the best time to send key employees to the foreign partner's plant for training. Advisers provided by the foreign partner for on-the-job supervision and training will generally stay on during start-up and the initial operating period. Thereafter, it may be found that the executive officer in charge of the technical aspects of the Joint Company, who will usually be the appointee of the foreign partner, will be able to provide the requisite additional training except, perhaps, when new models or products are to be produced by the Joint Company.

SPECIMEN CLAUSES

Foreign hereby undertakes to provide training and technical assistance to the Joint Company upon the following terms and conditions:

1. (a) Prior to the start-up of production, Foreign agrees to accept for training up to (maximum number) operating employees of the Joint Company at its plant located (site of Foreign's plant) for periods of at least ______ months each.

(b) It is understood that the maximum number of such employees to be trained by Foreign at any one time shall be ____ and that they shall be made familiar with all operational and technical aspects of production as relate to or are similar to the production operations to be undertaken by the Joint Company.

(c) The Joint Company shall have no obligation to pay for the costs of such training, other than to pay for their travelling expenses to and from (Foreign's country) and their salaries, if any.

(d) Foreign will use its best efforts to assist in arranging for immigration visas for such trainees and in finding suitable living accommodations at reasonable prices for such trainees while they shall be in (Foreign's country).

2. For a period prior to the start-up of production and during the initial operating period, which initial operating period shall not last longer than ____ days, Foreign agrees to provide to the Joint Company

(a) One qualified production supervisor, and ____ assistants, all of whom shall be graduate engineers, who, besides their responsibilities in respect of readying the plant and operating facilities for the start-up of production and the initial operating period, shall assume responsibility for training all the operating employees of the Joint Company in their operating functions.

(b) One qualified individual who will assist in the recruitment and hiring of the necessary employees and in the development of personnel and labour relations skills in the Joint Company.

(c) The Joint Company agrees to reimburse to Foreign all expenses in respect of such individuals, including their salaries, travel expenses and living expenses while in (host country), provided that such expenses, inclusive of all taxes but exclusive of travel to and from (host country), shall not exceed ____ per man per month.

(d) Local agrees to use its best efforts to arrange for their immigration visas into (host country) and suitable accommodation while they should be in (host country).

3. (a) The Joint Company shall be entitled, from time to time, and as it shall consider necessary, to require Foreign to send to (host country) such personnel or individuals as it shall consider necessary to assist the Joint Company in finding solutions to any of its problems and in training employees of the Joint Company to cope with such problems.

(b) The Joint Company shall reimburse to Foreign the expenses of such employees for the period during which they shall be absent from their regular business duties with Foreign, including their travel to and from the (host country) by economy fare air passage, their salaries and their living expenses, provided that the total of such expenses including all taxes but excluding the said air passage, shall not exceed ____ per man per month.

4. During such time as said personnel supplied by Foreign shall be rendering technical assistance and training to the Joint Company, they shall not be

regarded as employees of the Joint Company, for any purposes nor shall Foreign make any claim on behalf of such personnel arising from accident or any other cause.

SPECIMEN ENGINEERING CONTRACT

1. Recitals

WHEREAS the Joint Company has been incorporated for the purpose of manufacturing in (host country) the products listed in Schedule A hereto annexed under licence from Foreign and such other products as it may determine from time to time to manufacture;

WHEREAS the Joint Company requires engineering services of Foreign for the planning, process design, building, equipping, start-up, and the initial operating period of a plant and production facilities to manufacture the aforementioned products;

AND WHEREAS foreign is desirous of providing to the Joint Company the aforementioned engineering services;

NOW THEREFORE, in consideration of the premises and covenants herein contained, and the sum of $1 paid by the Joint Company to Foreign, the receipt of which Foreign hereby acknowledges, THE PARTIES HEREBY AGREE AS FOLLOWS:

2. Planning responsibilities of foreign

Foreign hereby agrees to provide over-all plans, including general building drawings, process designs, machinery foundations, the layout of machinery and equipment, and in co-operation with the Joint Company shall be responsible for and generally see to the realization of the project on the basis of the above plans.

Foreign's planning and work-out documents shall consist of the following:

(a) General plans for building and foundation;

(b) Layout of manufacturing plant;

(c) Plans concerning erection of machinery, tools, jigs and fixtures and testing equipment necessary for production;

(d) Generating plant and ancillary equipment;

(e) Plant equipment and materials for water supply;

(f) Plant equipment and materials for electrical power and gas supply;

(g) Machine tools;

(h) Miscellaneous auxiliary plant and equipment;

(i) Jigs, tools, and patterns;

(j) Office fittings and furniture;

(k) Erection and installation of plant equipment;

(l) All wiring and plumbing required for the factory.

3. Tenders and orders

Foreign shall render such assistance as shall be necessary to enable the Joint Company to invite tenders and word orders for the construction and completion of the plant and production facilities.

4 Technical assistance

Foreign shall make available to the Joint Company the necessary personnel to inspect all the work during progress and on delivery to the site, to supervise erection and installation, to inspect on completion and on behalf of the Joint Company to issue such acceptance certification as may be necessary. Foreign shall also provide the necessary staff to ensure the efficient operation of the plant, which said staff shall be available to the Joint Company from the start of construction until the end of the initial period of operation, which said initial period of operation shall be at least ___ days after completion of the first production run of at least one of the Licensed Products.

5. Guarantee

Foreign shall perform its duties and functions under this Agreement in such a manner as to ensure, and Foreign does hereby warrant and guarantee, that after the final production stage has been reached, the plant and production facilities shall be capable of producing at least (number) of (specify products) per year.

Foreign shall exercise a high standard of care and shall be liable for any negligence or failure to comply with the above production specifications. The liability of Foreign under this Agreement for failure of the production facilities to achieve such standards shall consist of all losses of profits occasioned to the Joint Company by the failure of the said plant and production facilities to meet these required standards, plus the costs of altering the facilities so that they conform to such standards.

6. Project engineer

Foreign will nominate and provide to the Joint Company a project engineer and such other supporting technicians as the Joint Company considers to be necessary to co-ordinate effectively and to control the execution of the work and to exercise general site supervision.

7. Obligations of Joint Company

The obligations of the Joint Company hereunder shall be as follows:

(a) To pay all salaries and expenses for all personnel provided under this Agreement; such personnel, their salaries and maximum expenses, including their costs of travel to and from the host country, are set forth in Schedule B annexed hereto.

(b) To purchase land for the factory site and have a geographical survey thereof performed;

(c) To undertake all steps necessary with local governmental authorities to ensure that the plant site is provided with adequate utilities, including rail and road transport, water, gas, electricity, and sewers and other waste disposal facilities;

(d) To undertake steps necessary, and to use its best efforts to arrange for transport of all materials, machinery and equipment required for the plant including clearance through customs and to pay all transport costs including freight, duties and insurance.

e *To carry out in connection with Foreign negotiations with consultants and civil contractors for the building based on Foreign's layout drawings, specifications (such as loads, dimensions) and recommendations and will in this connexion with the assistance of Foreign, undertake the following:*

(i) *Preparation of tender documents.*
(ii) *Invitations to bidders.*
(iii) *Selection of contractors.*
(iv) *Execution of contract documents.*
(v) *Issuance of orders for the commencement of work.*
(vi) *Appointment of qualified engineers and technicians for supervision of work.*
(vii) *Issuance of acceptance certificate as required.*
(viii) *All such other work as is normally required of or performed by an owner.*

Chapter 8

CHANGE OF PARTNERSHIP ARRANGEMENTS

Provisions for continuity of the Joint Company

It appears to be almost universally recognized that the success of any joint venture depends on the compatibility of the partners and on their ability to make continuing contributions to the joint venture. In other words, a primary concern of both parties will be to ensure not only the continuing compatibility of the partner selected, but to ensure that if the partnership should be dissolved, the new partner, if any, will also be compatible. If one partner withdraws either voluntarily or involuntarily from the joint venture, the remaining partner or partners will wish to secure new partners of their own choosing.

Withdrawal by one partner can arise in several ways, some of which are:

(a) The desire of a partner to sell his shares of the Joint Company;

(b) Death of an individual partner;

(c) The winding up, dissolution or liquidation of a corporate partner;

(d) The bankruptcy or insolvency of a corporate or individual partner;

(e) The desire of a partner to find a more compatible partner or to carry on the Joint Company alone.

To ensure the continuity of the Joint Company in any of the above or other events, the parties may adopt various approaches, some of which are discussed below.

Restrictions on transfer

It is common in joint-venture agreements to stipulate that no transfer of shares may be made without the consent of the other partners.

SPECIMEN CLAUSE

Foreign and Local agree that neither will sell, transfer, assign, mortgage, pledge or otherwise encumber or deal with any or all shares of the capital stock of the Joint Company without the prior written consent of the other, except as is hereinafter provided and provided that this provision shall not apply to transfer of directors' qualification shares so long as the beneficial ownership of such shares is retained by Foreign or Local as the case may be.

Buy-sell agreements

When one partner feels that the partnership relationship has broken down to the point where he must either buy out the other partner or be bought out himself, a buy-sell agreement is one way of dealing with this situation. Buy-sell agreements are frequently used in the case of 50/50 joint ventures where deadlocks arise which cannot be resolved. As such, they are an instrument of last resort only, but they do offer a reasonable means of settling the price at which one partner may buy out the other. The buy-sell agreement provides basically that the partner wishing to take such steps will make an offer to buy the other partner's shares upon specified terms. The offeree partner then may either accept the offer and sell his shares, or may himself purchase on the same terms and price the shares of the offeror partner.

An alternative version of the buy-sell agreement allows the initial offer to be of sale, giving the offeree the right either to purchase his partner's shares or to sell his own shares at the price specified.

The object of both versions is to ensure that the offeror's terms must be fair, because the offeree partner is given the option of accepting or making a reciprocal deal at the same price. Inequities may arise, however, when, for instance, the local partner wishes to carry on as a partner but cannot finance the purchase of the foreign partner's shares. This difficulty may be overcome by granting to the local partner in the buy-sell agreement some or all of the payment privileges discussed below in relation to rights of first refusal.

SPECIMEN BUY-SELL AGREEMENTS

A. Complex agreement

1. *Either Foreign or Local (hereafter in this clause called the "offeror") shall have the right at any time after_____years from the execution of this Agreement by notice in writing (hereinafter called the "original notice") to the other to offer to sell to the other (hereafter in this clause called the "offeree") all but not less than all of the outstanding shares of the Joint Company then owned by the offeror at a price and terms to be specified in the original notice, provided, however, that the price shall be payable on the "closing date", as hereinafter defined, and the balance shall be payable in no more than (number) annual instalments and provided further that the original notice shall provide that the offeree shall have the right to elect to sell to the offeror all of the shares of the Joint Company then owned by the offeree at the price and then on the terms set forth in the original notice.*
2. *Within 90 days after receipt of the original notice the offeree shall advise the offeror by notice in writing (hereinafter called the "notice of election") whether the offeree accepts the offer of the offeror to sell all but not less than all of the outstanding shares of the Joint Company owned by the offeror or elects to sell to the offeror all of the outstanding shares of the Joint Company owned by the offeree.*
3. *If the offeree does not advise the offeror by notice in writing within the said period of 90 days as hereinbefore provided then the offeree shall be deemed to have accepted the offer of the offeror to sell all but not less than all of the shares of the Joint Company owned by the offeror in accordance with the terms of the original notice.*

4. *The purchase and sale of the shares of the Joint Company resulting from the acceptance or deemed acceptance by the offeree of the offer of the offeror to sell contained in the original notice as aforesaid or the election by the offeree to sell to the offeror all but not less than all of the shares of the Joint Company owned by the offeree or the offeror, as the case may be as aforesaid, shall be completed on a date (hereinafter called the "closing date") no later than: ____ days after receipt by the offeror of the notice of election, or if the offeree does not deliver a notice of election, as aforesaid, ____ days after receipt of the original notice by the offeree, at which time the nominees of the party whose shares are to be sold (hereinafter called the "vendor") shall resign as directors, officers and employees of the Company and the other party who is purchasing the vendor's shares (hereinafter called the "purchaser") shall and will pay to th vendor the price or the portion thereof set forth in the original notice by cash or certified cheque.*

If, on the closing date, the vendor shall fail or refuse to complete the transaction, the purchaser shall have the right on payment of the purchase price (or the portion thereof then due) to the credit of the vendor in any chartered bank in the city of (name of city), and on giving notice thereof to the vendor to execute and deliver all such transfers, resignations and other documents and instruments which may be necessary or advisable in order to complete the transaction and the purchaser is hereby irrevocably appointed attorney of the vendor for and in the name of and on behalf of the vendor to execute and do any deeds, transfers, conveyances, assignments, assurances and things which the vendor ought to execute and do under the covenants herein contained.

If, on the closing date, the purchaser shall fail or refuse to complete the transaction, the vendor shall have the right to purchase the purchaser's shares and on payment to the purchaser of an amount equal to 75 per cent of the purchase price, to execute and deliver all such transfers, resignations and other documents and instruments which may be necessary or advisable in order to complete the transaction and the vendor is hereby irrevocably appointed the attorney of the purchaser for and in the name of and on behalf of the purchaser to execute and do any deeds, transfers, conveyances, assignments, assurances and things which the purchaser ought to execute and do under the covenants herein contained.

It is understood and agreed that neither party hereto shall make or assist in making any application to wind up the Joint Company after an original notice shall have been delivered pursuant to the provisions of this section.

B. Complex agreement: alternative version

1. *In the event that either Foreign or Local shall at any time during the currency of this Agreement or within one year after its termination desire to sell, assign, transfer or dispose of (otherwise than for the purpose of qualifying directors) any shares in the capital of the Joint Company for the time being owned and controlled by such party (such party being referred to below as the "offeror") then the offeror shall have the right to send a notice in writing (referred to below as the "notice") to the other party*

hereto referred to below as the [illegible] be signed by the offeror and shall [illegible]:

(a) The price of each share in the [illegible]

(b) An offer to sell all the shares in the Joint Company owned or controlled by the offeror at the said price.

(c) An offer to buy all the shares in the Joint Company owned or controlled by the offeree at the said price.

2. Upon receipt of such notice, the offeree shall be entitled within   days of receipt of this notice to accept either one of the offers contained in the notice, and the transaction shall be closed within   days of the date of such acceptance. In the event the offeree does not accept either of the said offers within this period then at the option of the offeror to be exercised by the offeror within   days after the lapse of the last mentioned   days period, the offeree (referred to below as the "vendor") shall be deemed to have accepted the offer of the offeror (referred to below as the "purchaser") to purchase all the shares in the capital stock of the Joint Company owned or controlled by the offeree and the transaction shall be closed within   days after the exercise of the said option.

Upon the date set for closing, the vendor shall transfer and assign to the purchaser all its shares in the capital stock of the Joint Company owned or controlled by the vendor, shall cause its nominees to resign from the Board of Directors of the Joint Company and/or any office or employment that such nominees may have with the Joint Company and the purchaser shall pay to the vendor the purchase price as set forth in the notice in full by cash or by certified cheque, provided that if at the closing date the vendor should be indebted to the Joint Company in an amount recorded on the books of the Joint Company and verified by the auditor of the Joint Company, the purchaser shall have the right out of the said purchase price to pay, satisfy and discharge all or any portion of any such indebtedness and to receive and take credit against the purchase price for the amount or amounts so paid on account of the indebtedness.

If on the date for closing, the vendor shall neglect or refuse to complete the transaction, the purchaser shall have the right upon such default, without prejudice to any other rights the purchaser may have, upon payment by the purchaser of such purchase price (less any adjustment with respect to the vendor's indebtedness to the Joint Company) to the credit of the vendor in any chartered bank in the city of (name of city) or with the auditors for the Joint Company, on behalf of and in the name of the vendor to complete the transaction as aforesaid and the vendor hereby irrevocably constitutes the purchaser the true and lawful attorney of such vendor to complete the said transaction and execute any and every document necessary on its behalf.

If a valid offer pursuant to the foregoing clauses of this Agreement shall have been made, neither party hereto shall do or cause or permit to be done anything except in the ordinary course of business of the Joint Company until the sale of shares in the Joint Company shall have taken place.

(Alternative short agreement

At any time after ____ either party may offer in writing to sell to the other party all (but not part) of the shares of the Joint Company then owned by the offeror party and its Affiliated Corporations, at a specified price per share and on such other terms and conditions as shall be specified in such offer. If the offeree party shall not have accepted such offer within ____ days after the giving notice thereof, the offeror party shall have the right, exercisable by giving written notice to the other party within ____ days after the expiration of such ____ day period, to purchase all (but not part) of the shares of the Joint Company owned by the offeree party and its Affiliated Corporations, at the price and on the terms and conditions specified in the offeror's original offer of sale. The closing of any sale pursuant to this clause shall take place within ____ days after acceptance of the offer by the offeree or the giving of notice by the offeror of the exercise of its right of purchase hereunder, as the case may be.

Right of first refusal

When one of the partners wishes to sell his shares, it is common for joint-venture agreements to give a right of first refusal to purchase such shares to the other partner or partners. In jurisdictions where a company is permitted to purchase its own shares, the right of first refusal may also be given to the Joint Company. The right of first refusal will depend upon the receipt by the selling partner of a *bona fide* offer to purchase by an outside party.

One problem inherent in a right of first refusal is in ascertaining the *bona fides* of the outsider's offer to purchase. It may therefore be made a condition precedent to the right of any partner to sell his shares to an outsider that any offer to purchase be presented in writing to the other partner. Another possibility is that the offeree partner must offer to sell his shares to the other partner at a specified discount from the offer price and that the other partner be then permitted to complete the sale of those shares to the outsider at the full option price. This approach gives the other partner the option of either purchasing himself or taking in a new partner and making a profit on the transaction. If this approach is adopted, any offer to purchase received by the selling partner will have to be one that can be assigned to and exercised by the successors and assignees of the offeree partner.

SPECIMEN CLAUSE

In the event that Foreign (Local) shall receive a bona fide *offer to purchase all but not less than all the shares it owns in the capital stock of the Joint Company, then Foreign (Local) shall not be entitled to accept such offer without, first, presenting to Local (Foreign) a certified copy of such offer, which said offer must be assignable to the Local (Foreign) partner, and, second, presenting to Local (Foreign) an offer to purchase such shares at a discount of ____ per cent from the price in the original* bona fide *offer to Foreign(Local).*

Financing by local partner

The biggest drawback in permitting one partner, especially the foreign partner, to sell his shares, even though the local partner receives an option or right of first

refusal, is that the local partner may not wish to take in the new partner but may be forced to do so because of inability to raise the necessary capital to purchase the withdrawing partner's shares. This problem may be overcome in several ways, including one or a combination of the following:

(a) Make the discount payable to the offeree shareholder sufficiently great that the profit accruing to the local shareholder upon completing the sale to the outside offeror will compensate for any incompatibility that may arise.

(b) Require easy terms of payment for the withdrawing partner's shares, including a long term, low or no interest, and a long period of grace.

(c) Require that dividends distributed to the foreign partner be in partial or full satisfaction of the local partner's payment obligations.

(d) Require that the payment be made only out of profits of the Joint Company paid to the local partner in the form of dividends.

The last approach has the commercial advantage of not permitting the foreign partner to abandon a sinking joint venture at a time when his efforts and co-operation may be required without suffering the loss of his investment if the Joint Company goes under. The drawback is that the local partner will be paying for the shares with after-tax profits (depending on the local laws, the Joint Company will have probably been taxed on its profits, and the local partner on dividends received). To overcome this problem, the tax authorities of the host country may be persuaded to permit special tax exemptions, such as exempting the local partner on dividends paid to him which are used to purchase the foreign partner's shares. The exemption may even go further and apply to corporate profits distributed to the local partner for such a purpose.

Option agreement

It will be recalled that one form of possible joint-venture arrangement is for the foreign partner to own 100 per cent of the shares of the Joint Company for a specified period, after which the local partner has the option to purchase some or all of the foreign partner's shares. Many refinements on this theme are possible, and an option of the local partner to purchase some or all of the shares of the foreign partner may be used, whatever the percentage ownership of the foreign partner may be.

The principal advantage of the local partner's obtaining an option to purchase some or all of the shares of the foreign partner is that if the Joint Company is financially successful, the option may be exercised; whereas if it is a failure, there need not be any capital investment by the local partner. In addition, the option gives the local partner the right to a large future stake in a successful venture without the initial need to raise capital and risk it in an untested venture.

The three main problems in such an option agreement are the timing, the price, and the necessary financing for the local partner.

Timing

The timing is important for two main reasons. First, the Joint Company will suffer if the option is exercised too early, before it can derive full advantage of the foreign partner's contributions in the form of technology, know-how, industrial property, managerial skills, technical assistance, training, and marketing assistance

Second, if the option is exercisable at a specified future date, the foreign partner may be encouraged to take either an extractive or blasé approach to the joint venture and his responsibilities to it.

The period before which the option becomes exercisable must be long enough to encourage the foreign partner to maximize his contributions to the joint venture, especially in training the local partner to be able to carry it on. This means that the foreign partner must have been able to achieve a fair return on his investment before the option date. The financial returns to the foreign partner may be measured in terms of some or all of the following items:

(a) Dividends;
(b) Lump-sum royalties;
(c) Continuing royalties;
(d) Management fees;
(e) Technical assistance and training fees;
(f) Salaries of personnel he provides;
(g) Interest on loans to the Joint Company;
(h) Interest (dividends) on debt capital of the Joint Company;
(i) Capital receipts from sale of shares in the Joint Company;
(j) Increase in his own earnings or capital worth derived from participation in the joint venture, which may be reflected in an increased value of his shares.

Some or all of the following approaches may be adopted to ensure the continuing interest of the foreign partner in the joint venture before and after the option date:

(a) Pay continuing royalties based on sales;
(b) Pay continuing interest on loans or debt capital;
(c) Require that the option price be paid out of future profits of the Joint Company;
(d) Provide for long-term repayment, which ensures that principal and interest obligations be subordinated to other obligations incurred in the ordinary course of business;
(e) Specify precisely the obligations of the foreign partner in the joint-venture agreement, both before and after, but especially before, the option date;
(f) Require a cash deposit by the foreign partner in trust for the Joint Company or local partner, which will be treated as liquidated damages upon default, to ensure the performance of his obligations;
(g) Provide for actual damages, over and above the forfeit deposit, occasioned by default of the foreign partner in his obligations.

Option price

Some possible approaches for determining the option price are as follows:

(a) Setting a predetermined price per share;
(b) Using a predetermined formula, such as book value or a specified earnings multiple;

(c) Using a predetermined process;
  (i) Evaluation by an independent third party such as a judge or firm of accountants;
  (ii) Arbitration;
  (iii) A combination of conciliation and arbitration;
  (iv) A court.

Setting a predetermined price may be too arbitrary an approach for joint ventures because the price is not likely to reflect the real value of the shares. If it is too high at the option date, the local partner will be deprived of the right to exercise his option at a reasonable price; if too low, the foreign partner will increasingly lose interest in the affairs of the Joint Company as the option date approaches.

Using some predetermined formula may also be too arbitrary. For example, the book value, as determined by the books of the company, may be far less than the actual value if maximum or accelerated depreciation has been taken. On the other hand, the plant may be obsolete at the option date. Furthermore, the book value may not in any way reflect the earnings potential of the Joint Company. If book value is used, it is common to exclude any valuation for any intangible assets, such as goodwill, and for intangible property rights, such as patents, trade marks, trade names, and licences.

Using a formula such as a certain multiple of earnings per share may be reasonable to the extent that earnings reflect the actual value at the option date. But the predetermined earnings multiple may be either too low to reflect a rapidly growing company, or it may be too high if the Joint Company's earnings are declining.

Using some form of outside arbitration for fixing the purchase price generally provides the greatest flexibility and ensures that a reasonable price will be reached. The problem with using an independent third party to determine the option price is to find a competent party acceptable to both partners. Generally, the outside party, if an individual, will not be a resident national, or, if a firm, will not be conducting operations in either the partner's country or the host country. One solution, for example, is to choose a judge of some third country. Another is to have the valuation determined by a court of a third country.

The option price is frequently determined by arbitration. Rather than relying on a single arbitrator, it is often best to have each partner appoint one arbitrator, who must then agree on a third arbitrator. Another approach is to provide for conciliation proceedings, whereby the parties attempt to reach agreement on the price. If they fail to do so, the question is referred to arbitration. This approach may be found best, since it combines flexibility with the opportunity of achieving a realistic valuation, and recognizes arbitration, which, like court proceedings, may be costly and time-consuming, as only a last resort.

SPECIMEN OPTION AGREEMENT

This Agreement made the ____ day of ____, 19__, between Foreign Manufacturing Company Limited, a company incorporated under the laws of (jurisdiction of incorporation) having its principal office at (site of head office), hereinafter called "Foreign" of the first part; and Developing Country Investments Limited, a company incorporated under the laws of (jurisdiction of

incorporation) having its principal office at (site of head office), hereinafter called "Local" of the second part.

It is agreed as follows:

1. *In consideration of one dollar and other good and valuable considerations, receipt which is hereby acknowledged, Foreign hereby grants to Local, and to any person or persons designated by Local, the full and exclusive right and option to purchase at the price hereinafter stipulated the shares of the capital stock of the Joint Company owned by Foreign, and all or any part of any additional shares of such stock hereafter acquired by Foreign, free and clear of any loan, charge or encumbrance, on the terms and conditions hereinafter stipulated.*
2. *This option may be exercised by Local at any time after (option date) by written notice to Foreign offering to purchase the number of shares set forth in such notice at a price which shall be the fair value of such shares at the date of such notice. [In determining such fair value, only the tangible assets of the Joint Company (excluding, without limitation, any value for goodwill, trade marks, patents, licences or other intangible property rights), together with any leasehold it owns will be taken into account.] In the event that Foreign and Local shall not have agreed on such fair value within 20 days after the notice of exercise of the option, such fair value shall be determined by (internationally recognized accounting firm), accountants, having a principal place of business at ____.*
3. *Upon exercise of the option, the shares with respect to which the option has been exercised shall be transferred by Foreign to Local and the purchase price paid, except as provided below, within 30 days after notice of such exercise of the option or, in the event that the fair value shall be determined by (name of accounting firm) within 15 days after notice of their decision.*
4. *If an authorization by the Government of (host country) be required for said transfer or payment, Local shall obtain such authorization and shall notify Foreign and the Joint Company thereof, and in such event the shares with respect which the option has been exercised shall be transferred and the purchase price paid within 15 days after giving of such notice of authorization by Local.*
5. *The purchase price shall be paid to Foreign at a bank to be designated by Local in the notice of exercise of the option, against delivery to Local of a properly executed document of a transfer relating to the shares covered by this option.*
6. *This agreement shall be binding on the heirs, successors and assigns of each of the parties hereto. This agreement may be assigned by Local, and on any such assignment the assignee shall have all the rights and be subject to all the obligations of the grantee hereunder.*

In witness whereof the parties hereto have caused this Agreement to be signed by proper signing officers and have hereto affixed their corporate seals.

Share certificates

The partners must ensure that shares cannot be transferred unless the transferee is bound by all the terms and conditions contained in the joint-venture agreement. It

may be possible under the law of some jurisdictions for a *bona fide* transferee for value who has no notice of the restrictions on transfer or other conditions in the joint-venture agreement to acquire the shares in the Joint Company free of such restrictions and conditions and any other equities existing between the joint-venture partners.

Notice of the existing equities may be given in fact or constructively, e.g. by being contained in the documents of incorporation of the Joint Company, where such documents are deemed to constitute notice of the provisions contained therein; or by being printed on the share certificates themselves. Apart, therefore, from setting out the restrictions on transfer in the documents of incorporation, it is a recommended safeguard that these documents specify that all share certificates are to be endorsed before issue with the restrictions on transfer. If such restrictions are too lengthy to be conveniently inserted, reference should be made to their existence in the documents of incorporation, which are open to inspection by the public.

SPECIMEN CLAUSE

The parties hereto agree that every share certificate of the Joint Company shall have noted on its face a statement to the effect that the shares represented by such certificate are issued in accordance with and pursuant to the provisions of this Agreement and further that no share in the capital stock of the Joint Company can in any way be assigned or transferred (save and except for directors' qualifying shares) unless the assignee or transferee executes an agreement indicating that such assignee or transferee adheres to and agrees to be bound by all the provisions hereof.

Changes in identity of the foreign corporate partner

The ownership continuity provisions discussed above protect against changes in ownership of the shares of the Joint Company. This topic deals with protecting against changes in the ownership or identity of the foreign corporate partner, which may be tantamount to the introduction of a new partner into the joint venture without the consent of the local partner. Such protection may be felt necessary because the success of a joint venture, as noted, often depends upon the personal relationships between the partners.

Changes in the identity of the foreign corporate partner can occur when the partner is involved in an acquisition merger or reorganization whereby control passes to new owners. Legally, the partner will still be bound by the joint-venture agreement but will be able to replace all the individuals involved in the joint venture and thereby destroy the personal relationships upon which the local partner has been relying for carrying on the work efficiently and harmoniously. Furthermore, the new owner can subvert the spirit of the joint-venture agreement in many ways, while still fulfilling his obligations. Another problem is that a change in ownership or control of the foreign partner can bring about business incompatibilities; the new owner may compete with the Joint Company in a way in which the former owner did not.

The joint-venture agreement may specify that if the majority ownership or the effective control of the foreign partner should pass from its present to new owners the joint-venture agreement will become voidable. This approach may deprive the

Joint Company of certain valuable continuing rights to licences, technical data, know-how etc., though it may be necessary if the new owner of the foreign partner is found to be wholly incompatible, for instance, because it is selling competing products in the same area as the Joint Company.

Another possibility is to provide that whenever the effective control of the foreign partner changes hands, all individuals appointed or supplied thereafter by the foreign partner to the Joint Company, including directors, officers, and technical assistants and advisers, must be approved by the local partner. This approach is perhaps better than the first one mentioned, since it requires the foreign partner to nominate individuals who will be compatible with the local partner and whose policies will not be inimical to the Joint Company.

SPECIMEN CLAUSE

It is hereby agreed that if the majority ownership (effective control) of Foreign shall pass from the hands of (names of persons with majority ownership or effective control), then all the nominees of Foreign to the Board of Directors of the Joint Company, and all officers and other personnel of whom it is the obligation of Foreign to provide to the Joint Company under the terms of this Agreement, must be first approved by Local before Local shall be bound hereunder to accept or cause to be accepted the appointment of such directors, officers, or other personnel.

SETTLEMENT OF DISPUTES

One of the most frequently expressed criticisms of joint ventures is that disputes between the partners hamper the efficient business operations of the Joint Company. Disputes may arise with respect to the validity, construction and performance of the joint-venture agreements and the related documentation, including the determination of the rights of the parties vis-à-vis one another and the Joint Company. It is difficult, if not impossible, to draft a joint-venture agreement in sufficient detail to cope with all eventualities and to regulate fully all aspects of the joint-venture relationship. In addition, even the most carefully worded agreement is subject to some ambiguities. Furthermore, changes in laws or in economic or political conditions may require a restructuring of the joint-venture arrangement.

It is essential, therefore, to provide procedures for settling disputes equitably and expeditiously. Such procedures include:

(a) Informal agreement;

(b) Conciliation;

(c) Arbitration;

(d) Court proceedings.

Informal agreement

The best approach is obviously for the partners to settle disputes by mutual agreement, without recourse to more formal procedures. While most disagreements will be resolved on the spot, it may be considered useful to insert a clause in the agreement providing for the co-operation of the parties to achieve this end.

SPECIMEN CO-OPERATION CLAUSE

The parties hereto ascribe to the principle that the expeditious and equitable settlement of disputes arising under this Agreement is to their mutual advantage and is in the best interests of the Joint Company. To this end, they therefore agree to use their best efforts to resolve all differences of opinion and to settle all disputes through co-operation and consultation.

Conciliation

Failing an informal agreement, one useful approach, although not often found in joint-venture agreements, is to provide for conciliation; this institutionalizes and formalizes the dispute-settlement process, often permitting a less emotional climate for the clarification of issues and consideration of alternatives, while at the same time preserving an informal atmosphere. There is no compulsion on the parties to achieve a solution, but if both are dealing in good faith, one can often be found.

SPECIMEN CONCILIATION CLAUSES

1. *If in the opinion of any party to this Agreement, any other party is in default in the performance of any obligation hereunder and the parties a unable to agree upon a mutually satisfactory solution, the first party shall give the other party written notice specifying the respects in which a default is believed to exist and calling upon such other party to remedy that default. Unless the matter is disposed of by agreement within 30 days after the receipt of such notice or such longer period as may be agreed to by the parties, then the complaint may be referred to a Conciliation Committee under Clause 2 hereof. Any complaint which either party does not wish to refer to a Conciliation Committee or which is not determined by the final ruling of a Conciliation Committee may then be submitted by the first party to arbitration as hereinafter provided.*

2. *The parties to any complaint arising under Clause 1 hereof may agree that the matter shall be referred to a mixed Conciliation Committee composed of four members, two nominated by each party, whose duty shall be to seek a friendly solution to the complaint. The Conciliation Committee, after having heard the representatives of the parties, shall give a ruling within three months of the date on which the complaint was referred to it. Such ruling must be unanimous in order to be binding.*

Arbitration

If conciliation fails, the dispute may go either to a judicial tribunal, such as a court of law, or to a quasi-judicial tribunal, such as a single arbitrator or an arbitration board. Almost every joint-venture agreement stipulates that unresolved disputes are to be settled by arbitration. Some of the advantages of arbitration are as follows:

(a) Arbitration is expeditious, whereas if court proceedings are required, the parties may have to wait years before a court hearing can be obtained.

(b) The arbitration award can be quickly implemented, without the requirement, as in the case of court decisions, of awaiting appeals to higher courts.

(c) The costs of arbitration will generally be lower than the costs of court proceedings.

(d) Arbitration procedures can be more flexible than those of courts, such as in respect of the times of sitting, the proper law to be applied, the introduction of evidence, and in ensuring that the arbitrator has personal expertise in the field of the dispute.

Three types of arbitration agreements, indicating some of the possible clauses may be included, are outlined below. Which type may be best will naturally on the requirements of the parties. It appears, however, that in most where arbitration is well developed, where, for example, arbitration rules ified, shorter agreements incorporating the local law or the arbitration ign jurisdiction or body are quite appropriate.

it has frequently been made that once a dispute reaches the court or , the partnership arrangement has suffered a fundamental and lial breakdown. This is not necessarily the case, however, and rtners derive mutual advantages from continued participation, the on decision may provide a new foundation for co-operation and

SPECIMEN ARBITRATION CLAUSES

A **Complex agreement**: provision for expert arbitrator

1. *(a)* ***Arbitration in accordance with the provisions of this Clause shall be the sole method of determining any dispute between the parties to this Agreement arising out of, or relating to, the execution or interpretation of this Agreement, the determination of the rights and obligations of the parties hereunder, or the operation of this Clause and which is neither resolved by mutual agreement or by conciliation as referred to above.***

(b) ***Arbitration proceedings shall be instituted by a notice in writing given by the complainant to the respondent.***

(c) ***If the dispute relates to technical or accounting questions, it may by agreement between the parties be referred either to a single expert or to a body of three experts, of whom two shall be appointed by the parties (one by each) and the third shall be appointed by mutual consent of the said parties. If the parties do not agree upon the single or the third expert, either party may request the Director of (name of an internationally recognized technological institution) when the question is a technical one, or the President of (name of an internationally recognized accounting institution) when the question relates to accounting, to appoint the single expert or the third expert.***

(d) ***If during the proceedings before an expert or experts acting under Paragraphs (a), (b) or (c) of this Clause, there arises in the opinion of the expert or experts or of either of the parties, a question of law (which expression shall include any question as to the interpretation of this Joint-Venture Agreement) the determination of which is necessary to a decision upon the technical or accounting question in issue, the question of law shall, if not determined by agreement between the***

parties, be submitted to arbitration under Paragraphs (e), (f), (g) and (h) of this Clause by the parties or either of them, either upon their own initiative or at the request of the expert or experts.

(e) If the parties do not agree that the dispute shall be referred to an expert or experts under Paragraphs (c) and (d) of this Clause, or if they do so agree but the appointments provided for are not made or a decision is not given within the time specified for the purpose, or if in the circumstances set out under Paragraph (d) of this Clause, either of the parties seeks the determination of a question of law, each of the parties shall appoint an arbitrator, and the two arbitrators before proceeding to arbitration shall appoint an umpire who shall be the President of the Arbitration Board. If the two arbitrators cannot within ____ days of the institution of the proceedings agree on the person of the umpire, the latter shall, if the parties do not otherwise agree, be appointed at the request of either party, by the President of the International Court of Justice.

(f) If one of the parties does not appoint its arbitrator or does not advise the other party of the appointment made by it within ____ days of the institution of proceedings, the other party shall have the right to apply to the President of the International Court of Justice to appoint a Sole Arbitrator.

(g) The appointment of an umpire or Sole Arbitrator under Paragraphs (a), (b) and (c) of this Clause shall be within the complete direction of the person authorized to make it, and the exercise of his discretion may not be questioned by either party. The person so appointed shall not be closely connected with, or have been in the public service of, nor be a national of (country of incorporation of the Joint Company), nor of the countries in which the other parties to this Agreement are incorporated.

If the arbitration is referred to the Arbitration Board, the award may be given by the majority. The parties shall comply in good faith with the award of a Sole Arbitrator or of an Arbitration Board.

2. *(a) If the party liable to execute the final award given in accordance with Clause 1 of this Agreement fails to comply therewith within the time specified in such award for compliance or, if no time is therein specified, within ____ days after the communication thereof to the parties, the party in favour of which the award has been given shall be entitled to seek the termination of this Agreement by a decision of the Arbitration Board or Sole Arbitrator made in accordance with Paragraph (b) of this Clause 2. Any such decision shall be without prejudice to any accruing rights and liabilities arising out of the operation of this Agreement prior to its termination hereunder, including such other rights, sums or damages as may have been awarded by the Arbitration Board or Sole Arbitrator.*

(b) The power to make the decision provided for by Paragraph (a) of this Clause 2, shall only be exercisable subject to the following conditions:

(i) The decision shall be made by the Arbitration Board or Sole Arbitrator who made the final award concerned;

(ii) If the Arbitration Board or Sole Arbitrator who made such award is for any reason unable or unwilling to act the question of termination for non-compliance with the award shall be referred to arbitration in accordance with Clause [illegible] hereof in the manner provided for determination of disputes.

(c) No decision terminating this Agreement shall be made unless the Arbitration Board or Sole Arbitrator shall have first prescribed a further period (not being less than   days) for compliance with the award and after the expiration of such further period shall have found that the award has not then been complied with.

B. Alternative short agreement

1. *Any dispute, difference or question arising between Foreign and Local concerning the construction, meaning or effect of this Agreement or any part hereof shall be referred to a single arbitrator if Foreign and Local agree upon one, and failing such agreement to a board of three (3) arbitrators, one to be appointed by Foreign, one to be appointed by Local, and one to be appointed by the two arbitrators so named by Foreign and Local.*
2. *If any party (herein called the "appointor") delivers a notice in writing to the other party hereto, appointing an arbitrator and requiring the other party hereto either to agree to such appointment or to propose a second arbitrator, and if such other party shall refuse or neglect to deliver a written notice to the appointor within ten (10) days of the receipt of the first mentioned notice either agreeing to such appointment or proposing a second arbitrator, the appointor may make application to a judge of the Supreme Court of (host country) for the appointment of a second arbitrator, and the second arbitrator so appointed shall be deemed to be the arbitrator appointed by the other party.*
3. *If the two arbitrators are unable to agree upon the person to be named as the third arbitrator, either of the said arbitrators may make application to a judge of the Supreme Court of (host country) for the appointment of the third arbitrator. The decision of the majority of the three arbitrators so appointed shall be final and binding on the parties hereto.*
4. *The provisions of the Arbitrations Act of (host country) shall apply to any such arbitration.*

Court proceedings

For the reasons enumerated earlier, the use of court proceedings to settle joint-venture disputes may be found impracticable. It is especially important to resolve disputes quickly, because the partners are forced "to live together", and the disruption caused by an unsettled dispute may make such cohabitation extremely difficult, with a concomitant disturbance of the Joint Company's operations. On the basis of experience, therefore, it is usually not recommended that joint-venture partners leave their disputes with the Joint Company or with each other to determination by court proceedings.

Nevertheless, the partners may not be able to agree to settle all disputes by arbitration and may decide instead that each shall have normal recourse to courts of law; it must then be determined which laws are to apply. In addition, when

arbitration is chosen, it is customary to specify which law shall be applied to settle all questions of law.

The proper law for determining all disputes arising out of the joint-venture agreements, including interpretation of the agreements themselves may be the law of:

(a) The host country;

(b) The foreign partner's country of incorporation;

(c) Some mutually acceptable third country;

(d) Certain rules of international law.

Because of his familiarity with the law of the host country, the local partner will usually wish it to apply. Since it is the law under which the Joint Company is incorporated, it is also the law which will most naturally apply in the absence of any provision to the contrary. One problem which may arise when it is specified that the law of the host country shall apply is that if the joint-venture agreements are executed in a different country, one of the partners is resident or incorporated there, and part of the performance is to take place there, a court of that country may decide that it shall have competence to determine any questions according to its own law. To obviate this possibility, even though it is remote, the joint-venture agreement should specify precisely which laws are to apply and also that all the documents may be executed in the host country.

When the laws of the host country are considered by both partners to be inadequate and those of another country are selected, it is best to choose arbitration for the settlement of all disputes and to stipulate that any questions are to be decided according to the law of that other country. In this way, the laws of the host country cannot be applied, unless the courts assume jurisdiction contrary to the stipulation that all questions are to be decided by arbitration. A further possibility is to stipulate that some form of international law shall apply. This approach has been adopted by at least one large joint venture, and it has certain advantages to offer in multipartite joint ventures where the choice of the law of the country of one of the partners may appear too arbitrary.

SPECIMEN CLAUSES

A. *All questions relating to the validity, construction or performance of this Agreement shall be governed by the laws of (host country).*

or

B. *This Agreement shall take effect as a deed made in (host country) on the date when it is executed by or on behalf of the last of the parties hereto executing the same, and shall be governed by and construed in all respects in accordance with the laws of (host country).*

or

C. *In view of the diverse nationalities of the parties to this Agreement, it shall be governed by and interpreted and applied in accordance with the principles of law common to (host country) and the several countries under which the other parties to this Agreement are incorporated, and in the absence of such common principles, then by and in accordance with principles of law recognized by civilized countries in general, including such of those principles as may be applied by international tribunals.*

SPECIMEN STANDARD CONTRACT PROVISIONS

In addition to the other provisions, the following are some clauses which it may be found helpful to insert in the joint-venture and related agreements

Designation of parties

SPECIMEN CLAUSE

This AGREEMENT made the ___ day of ___, 19__,
BETWEEN
FOREIGN MANUFACTURING COMPANY LIMITED,
a company incorporated under the laws of (jurisdiction of incorporation) having its principal office at (situs of head office),
(hereinafter called "Foreign")

OF THE FIRST PART,

AND
DEVELOPING COUNTRY INVESTMENTS LIMITED,
a company incorporated under the laws of (jurisdiction of incorporation) having its principal office at (situs of head office),
(hereinafter called "Local")

OF THE SECOND PART.

Recitals

In joint-venture agreements, where it is impossible to foresee all contingencies, recitals can assist in indicating the nature of the relationship between the parties and some of the circumstances under which the agreement has been entered into. As such, they do not constitute obligations or rights of the parties, but may be of assistance in interpreting the agreement.

Typical recitals may cover the following items:

(a) Identification of the parties, including the type of business and the geographical situs;

(b) The intention to form a joint-venture company;

(c) Reasons for entry into the joint-venture arrangement;

(d) Nature of the business operations to be conducted by the joint-venture company and its geographical situs.

(e) Any other item peculiar to the establishment of the joint-venture agreement that will serve to clarify the relationship of the parties

SPECIMEN RECITALS

WHEREAS Local (brief description of its business activities), and

WHEREAS Foreign manufactures (products) under certain patents in (country) and sells them under certain trade names and bearing certain trade marks in (geographical region), and

WHEREAS Foreign and Local desire to cause the above said products to be manufactured in (developing country), and thereby bring certain benefits to (developing country) including decreased imports, increased exports, employment, and a higher level of technical and industrial know-how; and

WHEREAS capital, industrial property, technical skills and know-how are required to produce (products) and market them in order to effect the said benefits, and

WHEREAS Foreign is in a position and is willing to supply such capital, industrial property, technical skills and know-how, and

WHEREAS Foreign and Local desire to form a corporation in (country of incorporation of joint-venture company) to carry out the production and marketing of the products, and to provide for certain arrangements relating to its operations and affairs, and

WHEREAS Foreign and Local intend that to these ends the provisions of this Agreement shall be carried out in a spirit of good faith and goodwill;

NOW THEREFORE, in consideration of the premises and covenants herein contained, and other good and valuable consideration flowing from each party to the other, the receipt whereof both parties by their execution of the Agreement do hereby acknowledge, the parties HEREBY AGREE as follows:

Definitions

It is common practice in legal agreements to define words and phrases that will be frequently used. In joint-venture agreements and the related legal documentation, definitions are usually set forth early in the agreement, and may cover the following items:

(a) The products which the Joint Company is being licensed to produce by the foreign partner;

(b) The components which the foreign partner may supply;

(c) Spare parts for the manufacture of the licensed products or machinery to be used by the Joint Company;

(d) The products which the Joint Company will manufacture.

(e) The territory in which the Joint Company may sell the licensed products;

(f) Subcontractors who may be authorized by the Joint Company to produce the licensed products;

(g) Date upon which the agreement will become effective;

(h) The technical information which the foreign partner is to supply to the Joint Company;

(i) Corporations which may be related to the parties and which the parties may agree to cause to be bound by certain provisions in the agreement;

(j) Aids to interpretation of the agreement;

(k) Any other frequently used phrases.

SPECIMEN DEFINITIONS

1. *"Licensed Products" means the devices and products described in Schedule_____ annexed hereto, together with all improvements and modifications thereof or developments with respect thereto. It shall also include any new products developed by Foreign (or by the licensor of the products to the Joint Company) subsequent to the date of this Agreement and related to the products described in Schedule_____ above, and appropriate amendments to the said Schedule_____ shall be hereafter executed to incorporate any such new products.*

2. *"Components" means those components and parts of Licensed Products which the Licensor may from time to time agree in writing to permit the Licensee to manufacture or procure within the territory (which the Licensor uses in its business operations for the production of such Licensed Products anywhere in the world);*

3. *"Spare Parts" means replacement parts for Licensed Products or for any part thereof;*

4. *"Territory" means (geographical areas where Licensed Products are to be manufactured and where they are to be sold by the Licensee), each existing and internationally recognized at the date of this agreement;*

5. *"Authorized subcontractor" means any company or other incorporated body or person for the time being approved by Local for the purpose of manufacturing on behalf of the Licensee the Licensed Products and Components.*

6. *"Effective Date" means the date upon which the last of the agreements attached hereto as Schedules shall have been executed by the parties thereto, including the date on which the Joint Company, having been duly constituted under the laws of (jurisdiction of incorporation) shall have executed the last of the agreements attached hereto as Schedules and become bound thereby.*

7. *"Technical Information" means engineering, manufacturing and originating information relating to the manufacture and servicing of Licensed Products, including drawings, blueprints, design sheets, sales of material, material specifications, photographs, photostats and general data, and designs and specifications relating to manufacturing equipment, tools and fixtures, but includes, however, only such information as is (1) available to the Licensor and (2) applicable to the operations of the Licensee under this Agreement.*

8. *"Controlled Corporation": A body corporate shall be determined to be controlled by one of the parties hereto if said party directly or indirectly holds or controls more than 25 per cent of the total votes conferred on the owners of the issued sale capital of that body corporate (for this purpose excluding from the total any votes which are available only on the happening of specified contingency or upon specific business).*
9. *In this Agreement, the singular shall include the plural and the masculine the feminine, except where the context otherwise requires.*
10. *"Start-up Period" means the period from the completion of construction of the production facilities until such time as the first of all types of products to be produced therein have been certified as being on specification and the Joint Company is satisfied that the production facilities are capable of producing the agreed-upon products in the agreed-upon quantities.*
11. *"Initial Operating Period" means the (amount of time) immediately following the start-up period and during which period Foreign's obligation for supply of technical and training assistance to the Joint Company shall continue as hereafter specified.*

Notice

SPECIMEN CLAUSE

Any notice required or permitted under the provisions of this Agreement shall be sufficiently given if:

(a) Delivered personally, in which case it shall be deemed to have been received at the time of delivery;

(b) Sent by prepaid registered mail, cable or telegram addressed as follows:

To Local at

To Foreign at

To the Joint Company at

or to such other addresses as may hereafter be furnished in writing by either party hereto to the other, and in the case of prepaid registered air mail shall be deemed conclusively to have been received on the fifth business day of the recipient following the date on which it is so mailed; and in the case of a cable or telegram shall be deemed conclusively to have been received on the second business day of the recipient following the date on which it is so sent.

(c) Sent by prepaid telex addressed as follows:

To Local at (telex address)

To Foreign at (telex address)

To the Joint Company at (telex address)

in which case it shall be deemed conclusively to have been received on the first business day of the recipient following the date on which it is so sent.

For purpose of ascertaining the date of mailing or sending or receipt in the above provisions, all times shall be calculated according to that of the time zone of the addressee or sender.

Force majeure

SPECIMEN CLAUSES

1. *Any failure or delay in the performance by either party hereto of its obligations under this Agreement shall not constitute a breach hereof or give rise to any claims for damages if, and to the extent that it is caused by occurrences beyond the control of the party affected, including, but without limiting the generality of the foregoing, acts of governmental authority, acts of God, strikes or concerted acts of workmen, fires, floods, explosions, wars, riots, storms, earthquakes, accidents, acts of a public enemy, war, rebellion, insurrection, sabotage, epidemic, quarantine restrictions, shortages of labour, materials or supplies, failures by contractors or subcontractors, transportation embargoes, failures or delays in transportation, rules, regulations, orders, or directives of any government or any state, subdivision, agency or instrumentality thereof or the order of any court of competent jurisdiction.*

2. *Without prejudice to any other remedies that may then be available to either of them, in the event of failure or delay arising out of or resulting from such causes, the parties will co-operate in an effort to agree upon the establishment of such alternative arrangements not subject to such failure or delays as will confer upon them benefits comparable in character and substantially equivalent in amount to these intended to be conferred by this Agreement, on terms and conditions not materially more burdensome to either party than those herein provided.*

Co-operation and implementation

SPECIMEN CLAUSES

1. *Neither of the parties hereto shall at any time during the continuance hereof deal with any of the shares of the Joint Company owned by it whether by sale, pledge, gift or otherwise in any manner inconsistent with the carrying out of its obligations hereunder.*

2. *The parties hereto agree that they will at any times exercise all voting rights conferred on them by the shares in the capital of the Joint Company registered in their names or beneficially owned by them in such manner as to ensure that the provisions of this Agreement are all complied with.*

3. *If any of the terms or provisions of this Agreement shall be declared illegal or unenforceable by any court of competent jurisdiction, then the parties hereto agree to do all things and co-operate in all ways open to them to obtain substantially the same results, or as much thereof as may be possible, including the amendment or alteration of these presents.*

Sole contract

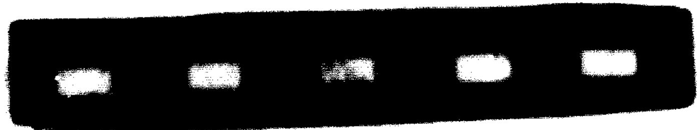
SPECIMEN CLAUSE

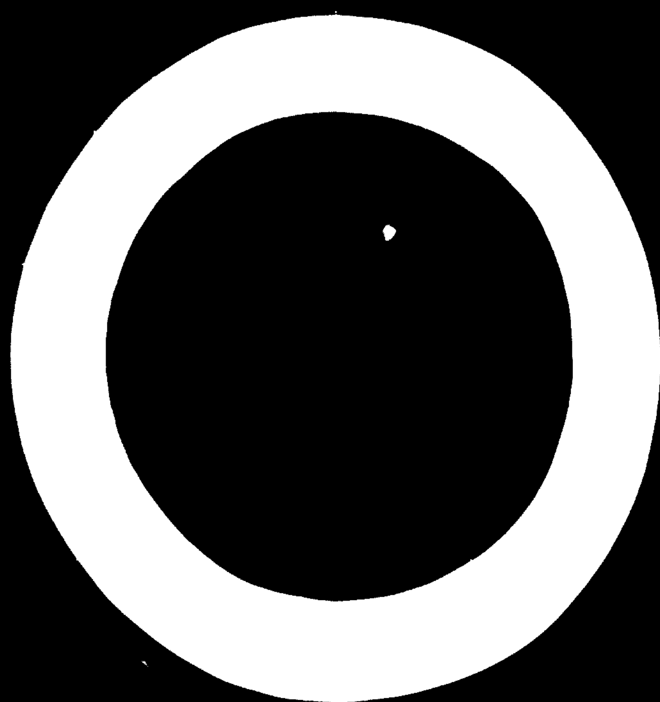
This Agreement constitutes the only agreement between the parties hereto and supersedes all prior agreements, expressed or implied, between the parties. This agreement and the terms and conditions of sale provided for herein may be modified only by written agreement by both parties.

Language

SPECIMEN CLAUSE

This Agreement shall be executed by the parties hereto in both a (language of local partner or host country) version and a (language of foreign partner) version, each of which shall be binding on the parties, it being understood that and agreed that in the event of any discrepancy between the two said versions, the (language of local partner or host country) version shall prevail.





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