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UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Tel: (+43-1) 26026-0 · www.unido.org · unido@unido.org

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JOINT VENTURE

AGREEMENTS

Prepared by

B. Vukmir
Branko

UNIDO Consultant

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INTRODUCTION

"Joint venture" is a term used to describe a form of international long-term cooperation, and the joint venture agreement (hereinafter referred to as "JVA") is a contract which embodies the will and intention of the parties engaged in such cooperation.

One of the characteristics of international economic relations is that, from time to time, they create new forms of international cooperation and thereby necessitate the creation of new contractual arrangements. Such new contractual arrangements become new types of contracts with their own problems, principles, solutions and rules.

Joint ventures came into being after the Second World War as a new form of foreign investments. Already, before the Second World War, it was a standard practice that enterprises from developed countries invested assets into other developed or developing countries. However, most of these investments were made without any local partners. They were hundred per cent foreign owned investments.

After the Second World War investors from developed countries, before investing into new and independent developing countries, started to search for local partners. Such partners were suddenly considered as an asset in establishing new businesses in foreign countries, since they could better solve local problems and they could give a local image to a foreign investor. On the other hand,

local entrepreneurs were eager to acquire foreign capital, know-how and technical skills, which foreign investors were ready to bring with them and which would enable them to start faster new and more profitable industrial undertakings.

Thus, all the ingredients for a successful start of a new form of international economic cooperation were there. Starting from the early fifties until today, joint ventures became a more and more used tool for foreign investment into productive capacities of developing countries.

At the same time, the very success of this form of international economic cooperation brought new problems and doubts. Some joint ventures turned out not to be as beneficial for developing countries as expected. Some JVA were considered as one-sided in favor of foreign partners and too expensive for local participants. Local investors started to feel that, when all the profits, management and license fees and other expenses are put together, they are paying too much and over too long a period for what they receive through a joint venture arrangement.

Joint ventures, as a form of international economic cooperation, started to be questioned as a vehicle for industrial development of developing countries. At the same time, international practice of joint ventures as well as the JVA, became objects of intensified studies.

During the last two decades, in many international fora it was pointed out that developing countries do not have enough experience in negotiating such arrangements, while transnational corporations, which became the best known

and the largest international foreign investor, mastered the techniques and skills of negotiating and structuring of joint ventures.

In this situation, many international bodies, primarily various agencies of the United Nations, stepped in and a long and tedious process of elucidation and exposing of various aspects of foreign investment practice has started to grow. This process is not yet finished.

The reason why this process is not yet completed is the fact that joint venture, as a form of international long-term economic cooperation, has shown itself to be a very resilient instrument. In spite of all the criticism and doubts, in the field of international economic cooperation, there is no substitute for joint ventures. If parties from different countries wish truly to join their forces in starting a new industrial production, if they truly wish to combine their efforts by linking their risks, they do not have today a better instrument than to form a joint venture. All other forms of cooperation, like for example, licensing, long-term industrial cooperation, subcontracting etc. are forms in which the risk of the participants is not really coupled to such a degree as it can be achieved through a joint venture arrangement.

These are the reasons why a continuation of studies of various aspects of joint venture arrangements and agreements is necessary and desirable. For these reasons, UNIDO has decided to continue with publications dealing with this problem. The present document is meant to be a contribution in this direction.

WHAT IS A "JOINT VENTURE" ?

The term "joint venture" is not used consistently in international business terminology. The plain meaning of the term "venture" means an undertaking involving chance, risk or danger. The term "joint venture" means a "joint undertaking", and parties in international business transactions tend to describe different kinds of their joint efforts to achieve a common aim, as a "joint venture".

Thus, for example, the term "joint venture" is very often used in civil engineering, construction, building, and equipment supply industries. Contractors, who decide to join their forces for a limited period of time in order to jointly build a plant, often call their agreement a "JVA" (sometimes also referred to as "consortium agreement").

The name "joint venture" in the construction industry does not in itself reveal the different types of possible internal relations of the parties who have concluded it. Internal relations of parties in such "joint venture agreements" are basically of two different types: one type is created on the basis of complete pooling of funds under a unified leadership with joint and several liability toward the client, while the other type, is an arrangements where every participant works for himself, although they have also undertaken joint and several liability toward the client. Such joint ventures are formed through a contract and they are therefore sometimes referred to as "contractual joint ventures".

However, regardless of the type the parties decided to create, such joint ventures are formed only for a limited period of time, namely only until the project for which the venture was formed, has not been completed. At the same time, such joint ventures do not become legal entities and, as a rule, are not even registered in any public register. They exist as long as the contract which created them remains in force. As soon as such a contract is terminated, the joint venture disappears. In many jurisdictions such associations are simply considered as partnerships.

"Joint ventures" which are subject of our study are of a different character. Such "joint ventures" were until recently referred to as "direct foreign investments" or only "foreign investments". Although these terms are still today correct, they have fallen out of use because these days foreign investments into developing countries are in most cases made with a local partner and not any longer so often by foreign investors alone.

Consequently, we may describe a joint venture in the field of foreign investments, to have the following characteristics:

In the first place, a "joint venture" in the field of foreign investments is a <u>long-term arrangement</u>. Such joint ventures usually have a life span of between 10 and 30 years. Sometimes, parties do not even provide a time limit for the duration of their contracts. The assumption under which these joint ventures are sometimes established is that the parties will jointly run an undertaking for as long as the venture is viable.

In the second place, the "joint venture" arrangement itself is only a framework for a much wider cooperation in four different aspects, namely,:

(1) in the partnership aspect;

(2) in the incorporation aspect of the whole arrangement, and

(3) in the field of transfer of technology.

(4) in the field of services which one partner may under take for the joint venture.

Joint ventures in the area of foreign investments, imply the creation of a new legal entity by incorporation of the partnership which was established through the JVA. The new incorporated body has an existence of its own, apart from the joint venture contract which made the basis for its creation. Therefore, such joint ventures are sometimes called "incorporated joint ventures", in contrast to the "contractual joint ventures" which are practised in the field of construction.

Moreover, JVA very often consist of a "package" of various contracts, since joint ventures are usually made when there is a need for new technology. Therefore, transfer of technology contracts and various other types of service contracts which may accompany an incorporated joint venture, make the legal structure of joint ventures even more complex.

We shall later in this document deal separately with each of these four different aspects of joint ventures.

As a consequence of indiscriminate usage of the term "joint venture", one should be careful to identify in practice exactly the type of the joint venture in question. In further discussions, unless we specify otherwise, our reference to "joint ventures" shall mean the joint venture in the foreign investment field and not in the construction field.

LEGAL FRAMEWORK OF JOINT VENTURES

The practice of international economic cooperation knows several distinct types of of foreign trade contracts. Such contracts may be in the field of international trade, international construction, international long-term industrial cooperation, foreign investment, transfer of tecnnology, etc. All such contracts have different rules and principles. Therefore, it is very important to identify the contractual type into which an intended business arrangement will fall.

All contracts have a legal environment into which they have to fit. Some contracts are more "international" than the others. For example, an international sales transaction may barely be concerned with domestic legislation

of the exporting or of the importing country. An international construction contract will probably be closer to the domestic legislation of the country where the works are being executed than an import sales contract into that country.

However, it is a feature of foreign investment contracts, that they are very deeply connected with the legislation of the host country. Not only that such contracts have to be made in accordance with the rules and regulations provided in the local legislation for such contracts, but the future joint venture enterprise will be located on the territory of the host country and will, therefore, be entirely subject to the rules and regulations of that country.

As a consequence of such close ties of joint venture agreements and operations of joint venture units with local legislation, attention has to be drawn to areas of law to which joint venture arrangements have to pay attention.

We shall, therefore, try to identify the legal framework of joint ventures, depending on the area of law which may be applicable to such arrangements.

JVAs have to pay attention to the rules contained in the following national areas of law:

(a) Contract law

JVA is a contract and therefore such agreements fall under the applicable national laws which regulate contracts.

National contract laws or "codes of obligations", as they are often called, have, as a rule, a general part and a special part. General parts usually contain general rules applicable to all contracts which are subject to that law, like, for example, rules on formation of contracts, authority to conclude contracts, mistakes in making contracts, penalties, damages, payment of interest, statute of limitation, etc. Special parts contain rules on the rights and obligations of parties which conclude specific contracts. Such specific contracts are then regulated in detail in such codes.

For example, the contract on sale of goods is usually the most detailed contract contained in various national laws. National codes contain also extensive rules on various other types of contracts like, for example, tenancy, contract of work, agency, mandate, lease, surety, etc.

The above described system of national codes is such that, for the contracts which are nominated in them, they contain specific rules on the rights and obligations of parties in such contracts. However, they do not contain any specific rules on rights and obligations of the parties in contracts which are "new" and which came into use only after the code was enacted and are, therefore, not even mentioned in such codes. However, even such "new" contracts are subject to the rules applicable to all contracts as contained in special parts of the national codes.

That means that all contracts, regardless whether they are nominated in the national codes or not, fall under the provisions of a national code.

Contracts on joint ventures are of a recent origin. Some forty years ago they were hardly known to exist. This is one of the reasons why most national codes do not contain any specific rules for such contracts. The other reason is that many countries have enacted special legislation for joint venture agreements, providing in such legislation elaborate rules for such contracts.

The fact is, that the rules on the rights and obligations of the parties in a joint venture agreement are not contained in national codes on contracts, although such contracts fall, along with all other contracts, under the general part of national contract laws or codes.

(b) Administrative law

There is a noticeable tendency in developing countries to regulate JVAs through special laws and through various administrative regulations. Many countries have enacted special legislation regarding foreign investments. Such special laws contain rules on the special conditions under which a JVA may be concluded, administrative procedure for registration of such contracts, approvals of state administrative organs necessary to be obtained for such contracts to enter into force, rights and duties of foreign investors, of domestic partners, etc. The same is true very often also for the transfer of technology contracts.

The purpose of such legislation was manyfold. On the one hand, the rules were shaped in order to protect the dome tic partner from excessive demands of foreign partners, and to secure a certain degree of control over foreign capital investments into their national economies.

On the other hand, such laws were also meant to be of help to foreign investors, since they have usually consolidated in one act the whole regulatory area of interest for the status of a foreign investor and technology supplier in that country. Furthermore, the whole field of JVA and transfer of technology agreements was contained in one act for each area, and they were thus easily accessible to all the interested parties.

(c) Company law

As a rule, a JVA will be followed by incorporation of an enterprise or a company in the country where it will be registered and established. Such registration may be effected in a country only in accordance with the provisions of the local company law.

Similarly, the internal management structure of the new company, the type of the company, the position and rights of shareholders, the rights of managers, the operation of the company, as well as many other questions, will all be regulated by the relevant national company laws.

(d) Taxation laws

The newly established company, as well as the foreign and local investors, will have to pay taxes in accordance with the taxation laws of the country of incorporation, while the foreign investor will also have to pay taxes on profits transferred to his country of origin or to another country in accordance with the competent taxation law.

(e) Foreign exchange laws

The incorporated company will exist and work on the territory of the local partner. Therefore, this company will in all respects be subject to the laws of the country where it was incorporated and where it has its seat, including to its foreign exchange laws. Therefore, the whole foreign exchange regime, including transfer of profits abroad, transfer of the invested capital, will be subject to such laws.

(f) Other laws

Whatever was stated under (e) above, is also true for the whole field of labor relations, customs, immigration, accounting and reporting, etc.

(g) International law

Foreign investments, in relation to other types of commercial transactions, have a peculiarity. Namely, in certain cases foreign investments could fall under the scope of international law. If that happens, governments will take over the case of their citizens and pursue the matter in

direct negotiations with foreign governments. If governments reach an agreement on the issue, they will arrange for a mutual compensation of agreed damages and/or of nationalized property, and the respective government will later compensate its citizens with the proceeds received from the foreign government.

It is an established rule of international law, that countries have the right to intervene in order to protect their citizens against acts of foreign governments, if citizens need such protection. This rule was extended by developed countries in the 19th century also to situations when the property of their citizens was taken away as result of an act of nationalization or expropriations of a foreign government.

As a result of these historical developments, it is claimed, that modern international law contains rules whereby states can protect their citizens against taking away of their property, as well as certain rules on the duty of governments to pay a prompt, effective and adequate compensation. The existence of these rules is not always readily recognized by some developing countries.

CODE OF CONDUCT OF TRANSNATIONAL CORPORATIONS

Elaboration of a Code of Conduct for Transnational Corporations was initiated in the early 1970 ties. The actual

work of the Code has started in 1974. By the end of 1987 the work on the Code was not yet completed although most of the provisions were agreed upon. However, some important provisions remained unresolved.

Among unresolved provisions are also the provisions dealing with the rules of international law on nationalization and compensation, definition of a transnational corporation, treatment of transnational corporations (non-discrimination" of foreign citizens and "national treatment"), and a few other provisions.

It is unfortunate that in spite of so many resolved issues, the remaining few open questions could not be agreed upon. An agreement on the Code would undoubtedly have a beneficial influence on the whole investment climate in the World today.

REASONS AND MOTIVES FOR JOINT VENTURES

In a JVA, there are actually four parties, of which two parties (foreign investor and local partner) are directly and contractually involved, while the other two parties (host Government and the Government of the foreign investor) are involved only indirectly. Nevertheless, each of these four parties has its own interest and reasons in promoting the joint venture.

From the point of view of the domestic investor (local partner), the following reasons can be pointed out:

- establishment of joint risk with a foreign investor in a particular undertaking;

- possibility of acquiring new technology for new and better products;

- securing of a permanent presence and involvement of the foreign investor in improvements of the product and in the increase of productivity;

- obtainment of more marketing expertise and possible opening of foreign markets;

- training of laborers and of the management;

- acquisition of new funds for research and development;

From the point of view of the foreign investor, the following reasons could be pointed out:

- possibility of acquiring new markets and thus increasing profits;

- possibility to minimize involvement and exposure as a foreign business interest through association with a local partner and thus obtaining a better position on the local market;

- possibility of lessening of political risks by taking a local partner;

- achievement of easier contacts with the host Government through a local partner;

- achievement of easier labor relations;

- engagement of capable local managers which can be trained and also used in other subsidiaries;

- possibility of obtaining special incentives from the host Government in different areas and thereby incre asing the value of its investment without actually paying for such incentives.

From the point of view of the host Government, the following reasons can be pointed out:

- contribution of foreign risk capital (hard currency) into its economy and consequent development of its own industry with the help of foreign risk capital and not through domestic or foreign loans;

- provision of new technology to its economy;

- access to new plants, machinery and equipment, raw materials, components;

- management of joint risks, including joint management of export promotion and sales on foreign markets with improvements in the balance of payments;

- easier access to foreign exchange;

- development of domestic enterpreneurial skill and potential;

- increased employment potential and increase in employ ment opportunities;

  strengthening of the industrial base and of the export potential;

- continued growth of domestic economy.

From the point of view of the investor's home country, the following reasons could be pointed out:

- expansion of own industries into foreign markets;

- better balance of foreign trade incomes;

- wider markets for own industry and more political influence.

As we can see, all the parties involved in a joint venture undertaking are interested to see that such joint ventures take place and that they develop into successful business undertakings.

RECENT TRENDS IN THE FIELD OF JOINT VENTURES

In the period after the Second World War it was obvious that direct foreign investments with 100% foreign owner-

ship is giving way to combined foreign and local investment. This trend was particularly visible in developing countries.

Due to the novelty of joint ventures as a new for of doing business and to the relative inexperience of negotiators from developing countries in negotiating such contracts, it became more and more usual that these types of contracts were heavily regulated by local laws and regulations. Developing countries started to enact elaborate laws regulating the whole field of foreign investments and prescribing sometimes detailed rules for such contracts.

Joint venture arrangements usually involved also transfer of technology which was regulated in separate but connected agreements. In order to influence the restrictive practices which owners of technology applied and requested through such contracts, developing countries started to regulate through their own laws principles of such contracts.

As a result of regulatory practices, it is usual today that JVA, as well as transfer of technology agreements, are heavily under influence of local legislation of developing countries. Many developing countries have enacted special foreign investment laws as well as special transfer of technology laws. These laws contain basic principles and conditions under which a foreign investment can be made as well as conditions for conclusion of transfer of technology agreements. In recent years, due to lack of loan capital, a trend toward softening of the conditions and requirements for such contracts has been noted. Foreign investment laws contain more and more incentives

for foreign investors, while the transfer of technology laws contain less severe conditions for such agreements.

Although more and more countries have enacted joint venture laws and regulations, these contracts in many countries remain politically controversial. As a consequence "foreign investment climate" in many countries is still not inductive to joint ventures. Nevertheless, many of those countries which have created a stable and positive environment for foreign investment have greatly benefited from increased influx of foreign capital and technology.

DEVELOPMENT OF A JOINT VENTURE RELATIONSHIP

In many instances a joint venture is created after the parties have already known each other for some time through their business relations. In such cases a joint venture is the end result of successful and compatible relationship in which the parties have jointly come to the conclusion that, by joining their forces and their knowledge, they could inject a new dimension into their relationship. It is often thought that such joint ventures have an advantage over joint ventures where the parties do not know each other before they conclude a JVA.

In any case, parties who wish to make a joint venture have to devote attention to the economic viability of their intentions before they actually proceed to create a joint venture. In this respect it is usual that the parties undertake to elaborate a feasibility study which will take

into account all the relevant factors and elements for the creation, operation and existence of the joint venture.

A feasibility study may be undertake in several stages in order to save costs. Thus, for example, parties may wish to elaborate, first, a pre-feasibility study, which shall examine only certain basic questions of possible future joint venture. If such a pre-feasibility study shows that a future joint venture would give negative results, there would be no need to elaborate a costly feasibility study.

If the pre-feasibility study gives positive results, parties may decide to continue with more thorough studies. Elaboration of a true feasibility study is essential for every joint venture. Such a feasibility study will show all the essential elements of the future joint venture from economic, financial, technical and sometimes also from the legal side. A feasibility study will answer many essential questions concerning the future cooperation, and in particular, it will show the capital requirements, nature of expected investments from respective parties, transfer of technology requirements, acceptable debt/equity ratio, raw material requirements, rate of return expectations, etc.

Although, existence of a feasibility study, however conscientiously made, cannot be a guarantee for a safe future, it nevertheless represents the most what the parties can do in order to foresee the viability of the intended joint venture and to diminish unexpected surprises in the future.

In many countries elaboration of a feasibility study is also required by the authorities for approval of JVA.

If the feasibility study gives positive results, parties usually start to negotiate the JVA.

NEGOTIATION PROCESS

Negotiations for conclusion of a JVA usually take a long time, because there are many issues which have to be solved before an agreement can be signed. A JVA is usually a long document, consisting often of several separate but interrelated contracts, which cover in details all aspects of the future relations of partners within the joint venture.

Although all JVA are similar in their basic legal structure, because all of them cover the same issues, there are no general conditions for such agreements like there are for other types of agreements in international trade transactions. The reason for this is the fact that every joint venture has many issues whi are unique. Many of such issues depend on specific requirements of national legislation where the joint venture will be incorporated and where it will have its seat. Therefore, it is impossible to draft general conditions which could be applicable to all of them.

Preliminary agreements

Because the negotiation process is long, there are often instances that the parties wish to make and sign some preliminary documents in which they put in writing the points on which they have agreed up to that point of time. Such documents are variedly entitled Letters of Intent, Heads of Agreement, Preliminary Agreements, Memoranda of Understanding, Protocols or similar.

The basic legal question in connection with such documents is, whether they are binding or not. The answer to this question depends to a great extend on the intention of the parties, on the wording of the document, and on the legal system according to which the document is to be interpreted.

Parties, sometimes, make a commitment to enter into a binding contract at a later time. Such "agreements to agree" or "contracts to make a contract" are in some legal systems (common law) generally not considered as binding. In civil law jurisdictions the approach is sometimes different. There are jurisdictions where an "agreement to agree" shall be considered binding if it contains all the elements necessary for the second agreement.

Sometimes parties make an agreement "subject to formal contract". In common law jurisdictions it was very often held that such arrangements are not binding. However, it is considered that the courts may judge whether the parties have really intended the conclusion of a formal agreement to be the condition for the contract, or they have merely expressed only a desire to make such a formal agreement without it being essential for existence of the

contract. However, if the parties made an arrangement and stated that the arrangement is valid "subject to contract", it is generally considered that they did not intend to be legally bound by that arrangement.

Parties, sometimes, issue the so called "letters of intent" on which they act, pending preparation of a formal contract. Although there is yet no clear authority in common law on the precise meaning of such arrangements, it is stated that it would be open to the courts to consider parties bound by such letters, especially if the parties had acted on those terms for a long period of time or if they had expended considerable sums of money in reliance on them. Contrary to this, in some countries (for example in Japan) a letter of intent usually contains a binding agreement on the terms contained in such a letter - further negotiations will be necessary only on parts not agreed upon in such letter of intent.

As we can see, if the parties did not express themselves clearly during negotiations, the courts may be put in a position to interpret their behavior. Such interpretation shall be made in such cases in accordance with the law applicable to that relationship and such laws, being different, may bring entirely different results from what the parties really wished to achieve and what they have expected.

Conditions

Foreign investment (joint venture) contracts and transfer of technology contracts are very often concluded under "conditions precedent". Such conditions postpone the

entering into force of the contract until the condition agreed as "precedent" was not fulfilled.

Licenses are often necessary for importation of certain goods, and approvals may be required either by governmental authorities or management organs. In all such cases parties wish to complete negotiations by signing a contract, but do not wish to bind themselves definitely or are not by law allowed to bind themselves before the receipt of necessary licenses or approvals.

In such cases, parties may sign a contract and agree that the contract shall enter into force only after they obtain the necessary licenses or approvals. Such conditions are in common law called "conditions precedent" and in civil law "condition suspensive". In such cases, although parties have signed a contract, they are really not obliged to perform it unless and until the condition is fulfilled, i.e. until they obtain the necessary license or approval. However, in such cases parties may not refuse the fulfillment of the contract for any other reason except the one for which they have agreed to be the condition. Likewise, parties are obliged to seek the approval in good faith and could not use the approval procedure for their own benefit in order to avoid the performance of the contract which they have signed.

For example, in joint venture and transfer of technology contracts parties sign and conclude contracts although they did not receive all the necessary licenses or approvals to enter into such contracts. In such cases obtainement of a license is a condition for entering into force of the JVA.

Another type of condition which is known, but little used in joint ventures and transfer of technology agreements, are the so called "conditions subsequent" (in common law) or "resolutory conditions" (in civil law). These conditions allow the parties to terminate a valid contract if a condition "subsequent" was not fulfilled. For example, parties may agree that the contract shall be valid from the moment it is signed, but that it shall be terminated if the exporter does not receive an export license. In such a case, the non-receipt of the export license or of the approval of the agreement is a "resolutory condition".

If a contract was signed under a resolutory or subsequent condition, the contract is valid from the moment it has been signed, but the parties are entitled to rescind it if the event described as resolutory condition did not materialize. In such cases termination of the contract will not be treated as a breach, but as a legitimate termination. However, in such cases parties should take note of the fact that the contract is valid from the date it is signed and that either one or both parties may start with its performance, to the extent such performance is not dependent on the resulutory condition (for example, starting to manufacture the products). If such course of action is adopted by the parties, they should foresee who shall bear the costs incurred if the contract is terminated before it can be be fully performed.

Foreign investment (joint venture) contracts and transfer of technology contracts are very often concluded under conditions precedent, because under various national

legislations special governmental approvals are very often required for the validity of such contracts.

CONTRACTUAL ISSUES

JVA have acquired a profile of their own. They can be easily differentiated from other types of contracts in the same field, namely, from other long term cooperation contracts between enterprises.

The basic legal features of a JVA are, the joint risk and the incorporation aspect.

Joint risk means that the partners do not attach any price or fee for participation in a joint venture. Parties invest their capital into the joint venture and they expect a return on the invested capital. If the venture is unsuccessful, they risk to lose their capital. The fact that foreign investors often tie joint ventures to the transfer of technology contracts and that they charge a fee for such transfers, is not a consistent part of joint ventures, but a way to diminish the risks connected with joint ventures. In instances when the technology is invested into a joint venture as capital, there are no fees for the use of it. The remuneration in such cases is in profits and in the return of the value of the investment at the end of the joint venture.

Incorporation of a new legal entity is a unique aspect of joint ventures, because it is only in these contracts that parties agree to jointly establish a new entity and to subject themselves to all the rules and regulations for

such new entities. In such arrangements parties lose the direct control over the invested capital, while the capital is managed in accordance with the laws regulating the existence of such legal entities. At the same time, a joint venture means that there is another partner who also acquires rights on the invested capital and who also has influence in managing the capital.

There is no other contract in the field of international long term cooperation which couples the interest of parties so closely as the JVA. There are also other distinct aspects of joint ventures which have their roots in the above features of JVA and which we shall review in the following chapters.

Purpose of the JVA

A JVA usually has an introductory part, often in the form of a Preamble, where the partners state the basic historical facts relating to the establishment of the JVA. Here, partners often state what do they aim to achieve by entering into the joint venture, what basic capabilities they have, what should be the aim of the legal entity which they will jointly create, what are the assumptions under which they are entering into the joint venture, as well as any other statement explaining the fundamental reasons and grounds for their association.

Although such recitals may seem superfluous, they really are very important because they will show the very fundamentals of the joint venture together with basic intentions, expectations and contributions of the parties at

the time when they agreed to enter into the joint business. If any one of these basic ingredients does not materialize in the future, or becomes a cause of dispute, recitals will show what was the original contractual intention of the parties.

Purpose of the joint venture is often also defined in the first few articles of the JVA.

Incorporation

Since joint ventures are carried out through separate legal entities, one of the first steps in a JVA is to chose the legal form of such a legal entity.

The legal form of the entity depends on the law of the country where the entity is to be established. In most countries in the World, there are special codes or company laws which regulate what forms of incorporation or partnership will be allowed on the territory of that particular country. Parties wishing to agree on the form of the future joint venture entity, have the freedom only to select among the forms allowed by the relevant code and they cannot select a form which the relevant code does not provide for.

Development of company laws in the World did not follow the usual pattern of division between common law and civil law countries. This development was more under the influence of factors common to the market economies than to differences in the legal systems. Advantages of doing business through various incorporated forms were freely used and copied by different countries and therefore we

have today a similarity of basic institutions and forms among different company laws of various countries.

Since there are great advantages of doing business through various incorporated forms provided in company laws, even some socialist countries which have abolished their company laws after the Second World War, have provided in their recent joint venture legislation, that the pre-war company laws may again be applied for purposes of establishing joint ventures with foreign participation (for example, Poland, Hungary, Bulgaria).

Consequently, we can say that the prevailing legal form of joint ventures today is the incorporated form as provided by various company laws, although there are also jurisdictions where this is not so (for example Yugoslavia, and more recently the USSR).

Advantages of incorporation

The main advantage of incorporation is that a new legal entity is legally separated from its founders. The new legal entity comes into being because partners in the joint venture have agreed to form it. However, such a new entity can come into being only if and when it is recognized by the state where the incorporation is to be done. Once the new legal entity is created, it acquires almost all the rights which otherwise only a physical person could have. Since the legal entity is juridically an independent and separate body from its founders, the founders have no liability for the debts of the new legal entity. This limited liability is the secret of the

success which legal entities had in development of market economies.

A legal entity can conclude contracts, acquire rights and undertake obligations, sue and be sued in front of courts and administrative organs and can generally act in business and commerce under its own name. Founders of a legal entity are not liable for the debts of the entity, except with the capital they have invested into the entity. Of course, they can guarantee the debts of the entity, but in such a case they would be liable as guarantors and not as founders.

Company laws usually provide also for such association of individuals (companies or physical persons) where the association does not lead to creation of a new legal entity. Associations of this kind are called "partnerships". Such partnerships are legally considered only as an expression of the will of the partners who created them, and consequently, partners are considered liable for the obligations of the partnership. The liability of partners is not limited and they are liable with all their property and assets in the same way as would be the case with the sole proprietorship.

Having in view the above characteristics of incorporation, it is not surprising that joint ventures around the World in most cases opt for an incorporated form. In such a form the liability of joint venture participants is limited only to the amount of the capital they have invested.

Form of incorporation

While the basic characteristic outlined above are common to all types of corporate forms, various company laws have different names for different forms, and sometimes, there are differences among national laws in details of certain similar categories of corporate forms.

For example, the "partnership" of the English law (where all the partners are jointly liable for the obligations of the partnership), is in German law called "offene Handlesgesellschaft" , and in French law "societe en nom collectif". As stated above, such partnerships are not considered legal entities, but only as associations of individuals.

A very popular form of limited liability company of a smaller size is the German "Gesellschaft mit beschrenkter Haftung" (the well known "G.m.b.H."), which is in French law a "societe a responsabilite limitee" ("S.A.R.L."), in English law a "private company", and in the U.S. law a "close corporation". This form is very suitable when there is a smaller number of participating partners who wish to limit their liability through the corporate form of a legal entity, but do not wish to raise the capital for the corporation through wider public subscriptions. In such a corporation the capital is divided among the members in quotas and no shares are issued to them. The capital which partners contributed to the corporation can be transferred to third parties only with the agreement of other members and not through transferable shares as is the case in joint stock companies.

The incorporated form which is very often used in market economies for large undertakings, is the "joint stock company limited by shares" of the English law, or the "joint stock company" of the U.S. law, or the "Aktien-gesellschaft" of the German and Austrian law, or the "societe anonyme" of the French law. Such incorporation is always a legal entity for which shareholders are never personally liable. The capital of such a joint stock company is expressed in monetary terms, it is divided into shares, and the shares are, in principle, freely transferable.

Which corporate form is the best for a particular joint venture is something the partners have to decide at the time of formation of the JVA. Their decision will, firstly, depend on the laws of the country where the joint venture will be created, and secondly, on the particular needs and intention of partners.

Since the laws of the country where the incorporation will take place are the most decisive, foreign partners in joint ventures have to study these laws in order to ascertain the special features of such laws. Legal systems differ one from another, and countries often jealously guard the differences and national characteristic of corporate forms allowed to be established on their territories.

JVA and management of the corporate unit

JVA is the document in which the joint venture partners lay down the basic rules for their association. In some

way a JVA could be compared to a "constitution" of partners.

National laws which provide rules for incorporation, provide also the rules how different corporate forms are to be managed. However, when partners agree to enter into a joint venture, they also wish to know what will be their influence in the management of the future corporatio.. This means, that partners can in their joint venture agreement agree on basic question of future management such as, which one of them will nominate the general manager of the future company, or how many members will have the Management Board of the future company, who will nominate or elect how many members of that Board, etc.

Parties can actually regulate their role and influence in the running of the future company already in their JVA. Since management of the future business is one of the most important questions to be solved among the partners before the company is actually formed, JVA's always contain elaborate provisions in this area.

Consequently, there are two aspects of joint venture arrangements. On the one hand, there is the JVA which sets the ground rules applicable to the whole relationship of the parties, and on the other hand, there is the new incorporated unit, which is set up in accordance with JVA and which in relationship toward third parties does not represent the joint venture partners but acts in its own name and for its own account. Third parties are not concerned with internal relations of the joint venture partners.

As pointed out above, the organization of the management of the joint venture unit depends to a great extent on the applicable national law. Joint venture partners may wish to limit the authority of the management, or may wish to introduce requirements of special approvals of certain decisions of management organs, etc. For example, JVA may provide that the management of the unit may not make certain decisions without agreement of the JV partners, or without approval of a member of the supervisory board. All such provisions can be made only in accordance with the applicable national laws.

Similarly, the same organs of different national corporate forms are not exactly the same. Thus, for example, the "President Directeur General" of the French "societe anonyme" is different from the Board of Directors ard from the General Manager of an English private or public company limited by shares, which are again different from the German "Vorstand" and "Aufischtsrat" of the German Aktiengesellschaft. German "Aufsichtsrat" has authority somewhere between a director and an auditor of an English company. An auditor is an independent controlling organ of the English company, entirely outside of the management structure of the company, but cannot be removed at will of the management. An "Aufsichtsrat" is an organ of the German company empowered to change the management.

An important question to be solved in a JVA is the protection of the shareholders who don't have the majority of shares. If the majority shareholders could simply vote their majority shares in all matters of concern to the company, the minority shareholders would not have any role to play and would be at the mercy of the majority shareholders.

It is very important to stress the fact that a minority position in a company does not mean necessarily that the minority partner is defenseless or that he is entirely at the mercy of the majority holder.

In order not to allow complete control of majority shareholders, corporate laws provide possibilities for the protection of the minority position. A partner who has less than 49 per cent of the shares or capital quota may wish to protect his minority position by acquiring a control over certain important decisions. For example, he may wish that his assent is required if the joint venture unit wishes to take a loan, or when it makes an investment decision of a certain magnitude, or when a change in the status of the incorporated unit is intended to be made, or in whatever other question he feels that his assent should be required.

To achieve this purpose he may provide for higher vote margins or different percentage voting requirements in the management board or calling of special meetings. In all such situation the protection of the minority position has to be made in accordance with the applicable law, but already should be provided for in the JVA.

A certain protection can also be achieved by providing procedures for calling of meetings and notifications of important decisions. Therefore, it is very important to secure that all partners have a chance to take part in the deliberations of the management organs on which they are represented.

In order to prevent management organs to make decisions if all the partners are not present, JVA and other relevant documents should provide that proper notices should be served to all partners informing them about the dates and places where meeting are going to take place, and that such documents also provide for a quorum necessary to make decisions. If a quorum is not provided for certain decisions, then a certain safeguard could also be achieved by providing that at least one representative of each partner is present at the meeting of the management organ when decisions are made.

Generally speaking, JVA may contain all what the partners consider of being of special importance for their relationship in the future company and which is different or special in relation to the applicable company law. All such provisions will ultimately be reflected in the basic documents of the future company.

In English company law such basic documents are called Memorandum of Association and the Articles of Association. The Memorandum of Association is the constitution of the company and the flexibility of the constitution depends, in principle, on the terms of the constitution. Articles of Association contain rules on the internal administration of the company. These rules can be altered, in principle, by the decisions of the company.

In a joint venture contractual structure, both the Memorandum and the Articles of Association will be under the influence of what the partners have agreed in their JVA. Since JVA is a contract, parties to a JVA are contractually bound to observe it.

Capital structure

All partners to a joint venture contribute their share of capital to the future corporate unit. These contributions, when valued and expressed in monetary terms, give a convenient basis for establishing the percentage of participation of each partner and for quantifying the shares to which they are entitled.
Company laws use the terms "nominal capital", "authorized capital", "issued shares" and "paid up capital" (or "stock") and it may be useful to explain these terms.

"Nominal capital" is the amount which the company proposes to be registered at its initiation for purposes of payment of registration fees and duties.

"Authorized capital" is the amount on which the partners have agreed that it will be the maximum capital which the company will be authorized to "issue" or to "subscribe", without asking the members of the company in general meeting for additional authorization.

"Issued stock" is the actually issued or subscribed capital by members, regardless if they have actually paid it up or not. If the partners to a JV agree, for example, that the total capital will be 1 million US$ and that each party will contribute 50%, then the authorized capital will be US$ 1 million, and the issued capital will be $ 500.000. However, if the parties authorize US$ 1 million and take up only US$ 700.000 in equal shares, then the authorized capital is US$ 1 million, but the issued capital is only US$ 700.000.

The "paid up capital" is the capital which has actually been paid into the company.

There are countries where the shares can be "issued" on partial payment and the balance can be "paid up" at a later time.

Management organs

Management organs are provided for in the applicable company laws and the JVA has to structure the management of the future unit in accordance with that law. Practice is different in various countries. However, the most common structure of a medium sized joint ventures will have the following organs:

- Meeting of shareholder (general meeting);
- Board of directors;
- Managing directors with the Chief Executive Officer (CEO).

General meeting of joint venture partners (who transform themselves into shareholders for purposes of the company law) is the supreme rule-making authority. General meeting is made up of all the shareholders and it decides by majority votes, unless a special majority is required for certain specific matters.

The Board of Directors will take care for the day to day business of the company, since the general meeting would be a very cumbersome body to do it. In principle, Board of directors is independent in making their decisions and the

general meeting cannot interfere, although it can dismiss and replace the Board. The general meeting can also alter the articles of association and restrict the powers of the Board. However, once they delegate the powers to the Board, they cannot make any longer decisions within such powers which they have delegated to the Board.

Managing directors are the ones who implement the decisions of the Board, because the Board itself is also a too cumbersome body to take care of the day to day implementation of its own decisions. Some directors will also be members of the Board and some will not.

Powers entrusted to the Board are entrusted to the collective Board and not to individual members (directors) of the Board. Once the Board makes a decision, the directors of the company will implement such decisions in their role of directors and not in their role as members of the Board.

The modern trend in company laws reveals a shift of effective power from larger organs to smaller organs. Consequently, the shift of power within companies has been in the direction from the general meeting to the board, and from the board to the management.

Founders of companies, including joint venture partners, have an opportunity to shape the inter-relationship between various organs of a company at the time when the company is not yet founded. Therefore, the provisions of the JVA are of such a crucial importance for the future company.

It is hard to say what would be the optimal size of a Board of Directors. What the partners usually strive for, is that there is a sufficient number of domestic directors. Other factors which usually influence its number are the local legislation, number of partners deserving to have representation of the Board, percentage of control of each partner, ability to provide suitable directors, requirements of special majority on the Board, requirements of business efficiency, etc.

It is similarly difficult to provide in advance for which decisions a joint approval of all partners, or of all members of the Board, or of a qualified majority, will be required. Such decisions may be the most important decisions which a joint venture is likely to make, such as making of a capital investment plan, making of a production programme, pricing of products, conclusion of major contracts, taking of loans over a certain limit, signing of Bills of Exchange over a certain amount, appointment of auditors, distribution of dividends, retention of profits, making up of reserves, etc.

JVA often contains an agreement of the parties concerning the chief executive office (CEO) of the future joint venture unit. Generally, it is considered that the selection or nomination of the CEO is the crucial issue in structuring the joint venture, and all parties usually try to gain an advantage by getting the right to select or nominate him. Since it is not always easy to reach an agreement on this issue, parties sometimes agree that each one of them will have the right to nominate the CEO for a certain period of time. Initially, this right may be given to the domestic partner (for one or two years) and later

to the foreign partner for the same period of time or vice versa.

Sometimes, parties may agree to have joint CEO's, which would imply the existence of two parallel CEOs who would be expected to make all decisions unanimously. Such a solution may create very sensitive situations, where an agreement of two executives would be necessary for every decisions.

If an agreement cannot be reached along these lines, parties sometimes agree to split the functions between different managers (marketing, production, procurement, book keeping, etc.) and have the prevailing influence in the nomination or selection of managers in charge of respective functions.

A word of caution must be inserted here. Since the JVA is the document which will influence the future organization of the company, and since the control of the company can be shaped and influenced through the control of various organs, it is of paramount importance to see that the controlling position of partners is consistently carried out through all the organs of a company. It has been noted that effective control of the company can be exercised sometimes by acquiring control of any one of the corporate management organs.

Furthermore, effective control can also be exercised through the control of various crucial operation of the joint venture, like, for example, through the application of the new technology, through the control of the production process, through the control of the procurement of

raw materials, spare parts, through marketing services and sales of products, etc.

The interest of developing countries is to develop managerial capacities among their nationals. At the same time, foreign investors have the primary interest to see joint ventures as successful business undertakings. These interests are not really opposed one to another. Developing countries should, therefore, strive to second all important managerial positions held by foreign nationals with their own nationals, and to provide in the JVA's an obligation of the foreign partner to train locals for all managerial positions.

Ownership

Under ownership of a joint venture we understand the participation in its capital. This participation is sometime referred to as "equity" or the money value of a property. "Venture capital" or "equity capital" is considered as capital invested into a venture, and a "venture" is an undertaking involving chance, risk or danger. Venture is an undertaking of uncertain outcome.

International equity joint ventures may be of different types, namely:

- minority foreign ownership (49%:51%);

- majority foreign ownership (51%:49%);

- equal foreign-local ownership (50%:50%);

- hidden foreign majority (49%:49%+2% in hands of a trustee controlled by the foreign owner);

- 100% foreign owned.

What type of a joint venture the partners will opt for is a matter to be decided from cases to case. Although ownership is important for the overall position of partners in the joint venture, it must be emphasized that its importance should not be overestimated.

Thus, for example, profits which one party derives from a joint venture do not depend exclusively on the relationship of equity investments. One of the partners may have separate contracts with the joint venture on the basis of which he may be receiving license fees, management fees, directors salaries, interest on loans extended to the joint venture, indirect fringe benefits, fees for additional services, transfer pricing benefits etc. All these proceeds may be much more substantial than profits of the joint venture.

Similarly, as we have pointed out in the earlier chapter on Management organs, the control of a joint venture does not depend only on the capital participation. A minority shareholder may acquire substantial and effective control of a joint venture through his know-how or through a

license agreement concluded with the joint venture, or through a management contract, or through veto powers provided for in the documents of incorporation, or simply by making the venture dependent on him through the supply of essential raw materials, spare parts, securing market outlets, services etc.

Transnational corporation sometimes use a nominee shareholder to effectively gain the control of the joint venture. Thus, for example, a foreign owner may have a minority position (for example 49%) but an equity of 2% is in the hands of a trustee or a "holder in trust" who is controlled by such a minority shareholder and votes always as told. Although such trusts may run contrary to the spirit of the local legislation, the practice is not illegal.

As we can see, neither profits, nor the control of the joint venture, are dependent solely on the ownership structure. However, ownership is, together with control and management, decisive for establishing the true position of partners in a joint venture.

What can be invested ?

Investments into a joint venture may be either in the form of tangibles (money, plant, machinery, raw materials, land, etc.) or in the form of intangibles (technology, technical information, marketing knowledge, management training, labor, etc.).

Contributions of tangibles and intangibles is a widely accepted practice and there are no reasons to object to

such practices. Partners are expected to give what will be of maximum use to the joint venture, and there is no reason to interfere with the wish of the parties to accept whatever contribution they may use.

The problem of contributions of tangible and intangible property is connected to the valuation of such investments. Such problems do not exist with contributions in monies or such contributions which have an open market price. However, whenever an investment is subject to valuation, the problem is how to value such an investment in a realistic manner ?

Many national legislation allow investment of tangible and intangible property in joint ventures, and many have a requirement that the valuation has to be "realistic".

There are important disadvantages in cases of unrealistic valuation of tangible or intangible investments. In such cases, there is a tendency to inflate payments for whatever is being invested (technology or equipment) and an inflated price will distort the whole capital structure, including the debt to equity relation.

If the value is artificially increased, foreign owner will withdraw higher profits from the venture than he would be otherwise entitled to, and he would additionally, withdraw the high value at the end of the joint venture as his capital participation. Furthermore, in cases of foreign technology, for example, its support may cease to be necessary or may become obsolete, while its presence is perpetuated through its conversion into capital. Moreover, it may be increasing in value with the increase of the value of the whole joint venture.

However, there are also advantages to investments of tangible or intangible property. First of all, for all such investments there is no need for cash payments. Acquisition of important technology in the beginning of a joint venture may be very important to partners because it represents a saving of foreign exchange. Likewise, production process will not be burdened with an expenditure of royalties or license fees and the technology will be "free" if there are no profits.

Furthermore, a foreign investor may be more interested to supply constant improvements for the invested technology, because only good production and favorable sales will secure his profits, and he is interested in profits because, under such arrangements, he will not be paid any fees for the technology turned into investment. His only remuneration will be in the form of profits from the joint venture. Furthermore, since this technology is an investment, there is much less likelihood that various restrictions, which are often attached to licenses, will be attached to the use of it.

For all these reasons, investment of tangibles and intangibles may not be discarded. Rather, countries and parties should endeavor to develop appropriate evaluation procedures. Such a procedure may be perfected with analyzing the component parts and identification of various inputs of the technology ("depackaging"). Such process can also be done with independent consultants and experts.

There may be great difficulties in defining an appropriate price for tangible or intangible assets and, therefore,

recipients have to develop methods of comparison of prices and values of such offers.

Because of the difficulties in ascertaining the true value of such investments, there were instances that countries have entirely forbidden such form of investments.

Financial policy

JVA usually contains a statement of the parties declaring what shall be the financial policy of the joint venture: whether the primary interest shall be to distribute profits or the aim shall be first to build up some reserves and later to distribute the profits. Consequently, the issue is: retention of profits v. distribution of profits.

For the host countries where the joint ventures are located it is, as a rule, more beneficial to provide for retention, while for foreign investors it is sometimes probably more interesting to opt for distribution and for receiving a fair return on their investment.

If parties agree that profits shall be retained, it would be useful to provide also the reasons for retention. Retained profits could be used for the working capital, for expansion or production and sales facilities, for repayment of loans, for redemption of capital stock, for compulsory reserves in certain jurisdictions, for reinvestments into the joint venture, for new acquisitions, etc.

Whatever the parties agree that it will be their financial policy in the joint venture, it is useful to make a declaration in the JVA. For example, if they agree to retain the profits, they should state that the financial policy shall be to retain profits in order to secure the greatest possible growth of the new company, or that dividends will not be paid until certain expenditures have been paid for, etc. Clarity in this area is quite important for future relations of the parties.

As a rule, foreign investor may have an interest to have the right to have outside auditors or accountants to control the books of accounts of the joint venture. Sometimes, there are different accounting practices in different countries and foreign investors may wish to have qualified personnel check the books of the joint venture. Generally, it is a standard practice to allow foreign investors the right to check the accounting books of the joint venture by experts which he may freely select. Foreign investor will often select local auditors for such tasks due to their better knowledge of local rules and regulations, but they should have the right to use foreign auditors, if they so wish.

Debt/equity ratio

One of the crucial issue in the sphere of financial policy is the relation between debt and equity, i.e. the proportion of loans which the joint venture will take to finance its construction to the equity which will be used for the same purpose.

As a rule, investments are financed only partly from equity invested by the partners, and partly from loans which the parties, or one of the partners or the joint venture itself, takes from local or foreign banks.

What should be the relation between debt and equity in any project depends on the economics of the project and on the economic strength of the partners. In certain industries it is economical to have a debt/equity ratio of 1:1, in some 2:1, while certain industries will support even a ratio of 3:1 .

The objection which could in principle be made to a high debts/equity ratio is that, if the debt is higher than the equity, there is no cushion for coverage of the debt in equity. Therefore, it is in the interest of host governments to see that an adequate debt/equity ratio is maintained. Another reason for maintaining the proper debt /equity relation is the fact that excessive use of local loan funds could be detrimental to other local industries which may be left without such funds. Furthermore, if the debt is guaranteed by local partner or by the joint venture, foreign investor will have a smaller exposure of his capital to risk, while he will have a great benefit in the increased value of the joint venture through loans and in greater profits gained from such increased value of the joint venture.

There are many Governments of developing countries which try to influence the debt/equity ratio [illegible]r joint ventures on their territories, sometimes even [illegible]scribing compulsory ratios.

If loan funds are provided from abroad, attention should be paid to the total cost of such funds. If such loans have an excessive interest rate, if the loans are made on an inter-company basis, if the loans are provided in the form of suppliers' credits - in all such cases the cost of the loan may outweigh the benefits. If the loans are too costly, the venture may be unprofitable, while the creditor will make a profit.

Foreign investors shun from guaranteeing loans to the joint venture company. Therefore, such guarantees are given either by local partners, or on the strength of the equity capital of the joint venture. At the same time, most loans for financing of joint ventures are taken on the local financial market. Such practices are beneficial to foreign investors, since they protect them from engaging their own funds or loan capacities, while protecting them from devaluation of local currencies.

It has been stated that inter-affiliate loans between local joint ventures and foreign parent companies may offer great flexibility to foreign concerns to transfer profits, without actually declaring them at all. If an inter-affiliate loan carries high interest rate, the profits of the joint venture will be diminished, while the foreign creditor will make a profit. At the same time, profits will be freely transferred in the form of interest payments, while the joint venture will incur a loss.

From the political side, such a picture of having losses abroad and profits at home, may also be beneficial. In such cases, foreign investors may have considerable profits in their books at the headquarter, while their

local image will not suffer by having no profits or very little profits from the joint venture.

The same results may be achieved by asking for high license fees, high royalties or other fees for services performed for the joint venture, for high prices of raw materials or components, spare parts, etc. In all such cases, the profitability of the joint venture will decrease, while the profits of the foreign partner may increase.

In order to control the overall economic results of foreign investments, for developing countries it would be useful to monitor total returns of foreign partners from joint ventures. Through such methods they could be able to ascertain the total net return which a foreign investor is receiving from his investment, and the total net outflow of foreign currencies made to foreign investors.

Monitoring of financial and overall business results of joint ventures is essential for host countries if they really wish to gain an insight into the costs and benefits of joint ventures and of foreign investments. Such monitoring would require coordination of various Governmental units and departments, together with elaboration of standard accounting and reporting practices.

Transfers and valuation of assets

For foreign investors, one of the principal issues in joint venture arrangements, is the question of transfers

of profits, of invested assets and of the increased values of their capital investment.

In many developing countries, transfers of money abroad is subject to foreign exchange regulations and these regulations may sometimes be restrictive. There is not much the parties can do in their contract in respect of transfers, because foreign exchange regulations are mandatory. Therefore, many foreign investors will judge the attractiveness of a country for foreign investments according to the freedom of transfers offered by a country's foreign exchange regulations.

Transfer of profits is the essential attraction for foreign investments. Therefore, such transfers are usually allowed to be made at least once a year, at the end of the accounting year.

Concerning the transfer of the invested capital, it is usual in JVA's to agree that the foreign investor will have the right to transfer the counter value of his invested cash amounts and other capital investments in the values as recognized in the JVA. That means, that the invested technology (know-how, trade marks,, patents, etc.) which have been invested and not given under license, will in the JVA be expressed in a certain value terms, and that the expressed value shall, at the end of the JVA, represent the invested capital. Since the invested capital is returned to parties at the termination of the joint venture, and after all the accounts are settled, foreign investor will be entitled at that time to receive the counter value of all of his invested capital;

At the end of the joint venture, the question may arise concerning the true value of the joint undertaking, particularly in cases when the value of the undertaking is higher that the amount of the nominally invested capital. If the value of the undertaking has increased above the actual worth of the invested assets, foreign investors may wish to participate in the distribution of that worth.

The actual worth of the undertaking may increase above the net worth of the assets due to the goodwill gained by the undertaking during its existence, or by capital expansion during its existence, or by expansion of the undertaking through loans, earnings, etc.

JVA's sometimes contain methods of calculating the net worth of an undertaking at termination, taking into account the projected profits on the basis of the past performance. If such methods are adopted, deductions from such projected profits should be made for royalties otherwise payable, income taxes payable by the foreign partner, as well as other expenditures payable from profits.

From the point of view of developing countries, the most favorable method would be the return of the book value of the investment made. In such instances, the growth of the joint venture would not be reflected in the value of the returned investment. However, if the book value exceeds the total participation of the parties, and the parties wish to share the surplus, then the surplus value is sometimes divided between the partners in proportion to their participation in the book value.

Another method proposed sometimes, is the return of the "market value" of the joint venture. It is not always easy

or feasible to establish the market value of an enterprise. The "market" itself is not an easily defined category, because "world market" or "local market" values may be different.

Aside from the question of the valuation of investments, there is also the question of the manner of payment of the investment to be returned, which also has to be regulated in the JVA. Parties sometimes agree that the investment will not be returned at once, but that it will be returned in installments. In such cases the investment is treated as a due debt. On such due amounts parties may already in the JVA agree on the interest, securities for payment (promissory notes), guarantees, installment periods, etc.

Approvals

In most developing countries foreign investments are allowed only if the JVA is approved by the competent authorities. That means, that the parties are free to negotiate JVAs and are free even to sign the JVAs, but for a JVA to become legally binding and enforceable, it must be approved by competent authorities.

The same situation exists in many countries regarding the transfer of technology agreements.

In international economic relations, the practice of requiring approvals of certain types of contracts, is not the rule. In principle, international trade and international commercial transactions are based on the freedom of parties to contract and to regulate their contractual relations as they deem fit. However, certain areas, like

joint ventures and transfer of technology contracts, have been reserved for stricter governmental control. The reason for such practice lies in the fact that developing countries considered the terms of trade in these areas to be unfavorable to their enterprises. Consequently, the legislation of developing countries was directed, not only toward the control of foreign investments on their territories, but also toward protection of the contractual balance of their enterprises in such types of contracts.

Governmental or central bank approvals are also often required for foreign loan agreements.

Incentives

Many governments of developed and developing countries are trying to attract foreign investments. For these purposes it is not unusual that local legislation provides various facilities for foreign investors. Such facilities are often called "incentives".

There are various kinds of incentives, starting from construction of infrastructure for certain projects up to offering various fiscal (tax, customs, etc.) and non-fiscal facilities.

Among the fiscal incentives, one of the most usual is the income tax holiday for newly established enterprises. Such tax holidays may be extended for several years, and they may be different for different type of activities. Incentives may also be in the form of investment tax allowances, in additional deductions from taxable incomes,

in duty free importation of machinery, equipment, spare parts, in tax credits on domestic capital equipment in lieu of free custom duties had the equipment been imported, in exemptions from contractor's taxes, in exemption from export taxes, in accelerated depreciation of buildings, equipment, machinery, in exemption of custom duties on imported spare parts, in tax credit on power cost differential between the power cost in the host country and surrounding countries, etc.

Among the non-fiscal incentives, there may be offered different facilities in relation to various duties which domestic enterprises may have, promises of more speedy custom processing of imported equipment, spare parts, raw materials, possibility of retention of foreign currencies on special foreign currency accounts, employment of foreign nationals, tariff protections for a specified period of time for certain industries, special pioneer industries incentives, etc.

Change of partners

JVA are concluded on the basis of personal selection and knowledge of the joint venture partners. Therefore, it is important for the partners to secure a stability and continuity of their contractual relations. In order to achieve these aims, JVAs often provide for special procedures in cases if a partner wishes to abandon the joint venture and to transfer his participation to another partner.

There may be different reasons for change of partners. One of the partners may simply wish to sell his shares because

he wishes to enter a new line of business and needs cash. One of the partners may want to wind-up his business or has become bankrupt or insolvent. One of the partners may wish to find a more compatible partner or a partner with new or better technology, etc.

Whatever the reasons for change of partners may be, JVAs often provide for special procedures in such cases. Sometimes, even foreign investment laws provide for a duty of the partner who wishes to leave, to offer first the other partner to buy his shares ("right of first refusal"). Only if the other partner does not buy, the first partner is allowed to offer his shares to third buyers but under the same conditions as made to the other partner.

Partners may also agree in the JVA, that the local partner will have the first option on the foreign partners' share. Such arrangements, sometimes provide for exact time when such an option will mature and will have to be exercised (for example, 5 years after the start of the operation of the joint venture). Sometimes, such options are made dependent on the success of the venture - if the venture is a loss, the option will not become effective.

In any case, it is important to provide that the new partner may not obtain the shares unless the transferee is bound by all the terms and conditions of the JVA. In such a case, if there are share certificates, each one will contain a statement to the effect that all shares are issued in accordance with the JVA and cannot be transferred unless the transferee executes an agreement that he accepts all the provisions of the JVA.

Sometimes, change of partners conditions are made easier in JVAs if the new partner is only a subsidiary or an affiliate of the old partner.

Duration of joint ventures

In some developing countries the duration of joint ventures is limited to a certain period of time. In some jurisdictions, the time limit is not explicitly prescribed, but it is stated that joint ventures have to have a time limit.

In principle, foreign investments are made for the purposes of establishing a new business in a territory, not necessarily for a limited duration. Existence of a time limit is, therefore, a disincentive to foreign investors.

From the economic point of view, an investor, if he agrees to a time limit for the joint venture, will judge the duration of an investment primarily in terms of possible amortization of the invested capital and fair return on the investment. If a joint venture is capital intensive, the duration of the venture has to be longer, and maybe even a possibility of extension will be required. If there is not much risk capital involved, the duration may be shorter.

Sometime, JVAs provide for a slower "phase out" or "desinvestment" over a period of a few years. In such cases investment is being diminished in an orderly fashion over a certain number of years, until it is completely paid out or diminished to the intended size. Parties may use this

method in changing the majority and minority positions or simply as a way of liquidating the joint undertaking and leaving it under the exclusive control of one of the partners.

Impediments for performance

One of the basic principles of contract law is that the contracts and contractual obligations have to be performed. Once the parties have concluded a contract, they may free themselves from undertaken obligations only under certain conditions. Legal systems usually recognize which impediments will be treated as justifiable excuses for non-performance of contractual obligations.

The best known and legally recognized excuse for non-performance of contractual obligations are the cases of "force majeure", as known in national legislations. In the French Code Civil (as well as in other legislations) "force majeure" is defined as an absolute impossibility to perform. According to this notion, the obligor is actually prevented from fulfilling his obligations due to causes for which he is not responsible.

In today's contractual practices, the notion of "force majeure" is sometimes used in such a way that it does not assume an absolute impossibility to perform, but only an occurrence of events which make the performance more difficult or onerous. If a clause is phrased in such a way, we do not have a classical "force majeure" clause, but a modern "hardship" clause. Such clauses provide for non-performance if the conditions have changed in such a manner to have made the performance for one party more

difficult or more costly than it was envisaged at the time the contract was concluded.

In contracts which stand under the influence of English law, the term used for excusable impediments is the term "frustration". Frustration is very similar to "force majeure", since it also requires an absolute impossibility of performance. However, frustration is different in another important aspect. Namely, under a "force majeure" civil- law concept, in the case of an occurrence of an event of "force majeure" the performance may be temporarily suspended. Once the impeding event has ceased to influence the performance, parties may continue with the performance of the contract. Under this concept, "force majeure" is cause for only a temporary suspension of performance of contractual obligations.

The concept of "frustration" is different, because under English law , an event which "frustrates" the performance, destroys the very foundation on which the contract was made. In such a case, the parties do not have a choice, either to wait for the cessation of the impediment or to terminate the contract, as it is often the case in "force majeure" clauses. In cases of frustration a contract is automatically considered as cancelled once a "frustrating" event has occurred.

In JVAs it is usual to provide for a "force majeure" clause and not for a "hardship" clause. Foreign investment contracts are contracts for a long duration and the parties do not consider it feasible to provide for an "easy" way out which would allow their partners to leave the undertaking. Parties to a joint venture undertake long term responsibilities and the very possibility that one of

the partners may abandon the project if the performance becomes more costly than originally planned, may leave the other partner in a very awkward position.

Similarly, parties may be reluctant to agree on a "frustration" clause, since that would mean an automatic termination of the contract. Therefore, the "force majeure" concept may be the best suited for joint ventures, since in such an arrangement the impeded party will be allowed to suspend the performance of its obligations while the impediment lasts, but it will have to continue with the performance once the impediment has stopped.

However, in such cases parties may agree on a limit to the duration of the suspension. If, for example, the impeding event lasts more than 6 months, or a similar period, parties are then free to terminate the contract. Otherwise, they are only allowed to suspend its performance as long as the impeding event actually prevents them to perform.

Termination

Termination of a JVA is possible through the usual legal instruments applicable to termination of other contracts, such as "force majeure", duration, suspension, etc.

However, there is an important difference between a JVA and other contracts. Namely, termination of the JVA itself has no bearing on the existence of the separate legal entity which was established in accordance and following the provisions of the JVA. Therefore, it is not sufficient to terminate the JVA in order to terminate all legal

relations between the parties. The parties have to terminate also their relationship in the enterprise which was established on the basis of the JVA - only then, the termination will be completed.

Consequently, a complete termination of a JVA could be accomplished through two different steps:

- termination of the JVA itself, and

- termination of relations between partners in the enterprise established in accordance with the JVA.

Termination of a JVA may occur as a consequence of various reasons, such as:

- economic reasons connected with the venture itself (unprofitability);

- reasons on the side of the partners (bankruptcy, insolvency, etc.)

- breach of contract from one of the partners;

- expiry of the agreed time.

It is advisable that partners provide in the JVA the grounds for termination of the JVA and the conditions under which such grounds can be invoked (for example, unprofitability in consecutive number of years).

If one of the partners has terminated the JVA in accordance with its terms, parties have to regulate all other

matters pertaining to the JVA, such as transfer of profits, capital, know-how, patents, conditions for the return of invested capital, as well as all other outstanding issues.

Above all, parties have to agree on how to regulate their relations in the independent enterprise which they have established in accordance with the JVA. In this respect, parties can do the following:

- decide to liquidate the enterprise and to cease its operations all together. In this case the problem is primarily in the division of the capital and the return of what can be saved from the enterprise through sales of its assets, collection of its receivables and payments of its debts.;

- decide that one of them will take over the enterprise and continue to operate it without the participation of the other partner. In such a case, the leaving partner has to receive his investment back. If the established enterprise is a company with shares, the repayment may be done through a simple sale and purchase of the shares. If the enterprise has no shares, the remaining partner has to see to it that he buys out the leaving partner. The payment has to be made in accordance with the JVA or in accordance with whatever agreement the parties may reach at the time of termination.

Settlement of disputes

It is an accepted fact that parties to international commercial transactions, and consequently the parties to international joint ventures, are free to agree on the forum which shall have the jurisdiction to solve the disputes arising out of their contracts. The parties also have the freedom to choose the applicable law.

Consequently, parties may agree that their disputes shall be solved either by the courts of the host country, or by arbitration which they chose. Furthermore, they can agree on the application of any legal system they like, even the one which is totally unrelated to their contractual relations. The only exception may be in regard to the mandatory laws of the host country regulating the existence of the undertaking as such. As a result of this freedom to make their own choice, international arbitrations are more and more frequently used in international commercial contracts.

There are today many "institutional" arbitrations, namely such which are attached to some institution. A good example is the Arbitration Court of the International Chamber of Commerce (ICC) in Paris. Another example is the Arbitration Centre established under the auspices of the Afro-Asian Legal Consultative Committee in Kuala Lumpur (Malaysia) and its Regional Arbitration Centre in Cairo. There are also many national Chambers of Commerce which have standing arbitration courts and which are ready and willing to arbitrate and offer arbitration facilities if the parties so agree.

The World Bank has been the instrumental in making the Convention for Settlement of Investment Disputes. Until today (end of 1987) there are almost 100 countries which have signed the Convention and 89 countries which have ratified the Convention. The Convention provides for an arbitration facility which is administered by the International Centre on Settlement of Investment Disputes (ICSID) within the World Bank in Washington. ICSID is available in cases of disputes which have their origin in "investments". This term usually encompasses foreign investment, but can also be used for disputes connected with long term construction contracts. Another feature of ICSID arbitration is that at least one of the parties involved in the dispute must be a Government or a governmental authority. In all, 23 disputes have already been submitted to ICSID for settlement.

If the parties opt for an ad hoc arbitration and not for an institutional arbitration, they will usually provide in their contract that each party will nominate its own arbitrator, and these two arbitrators will nominate the third one. The difficulty of such ad hoc arbitrations is that one of the parties has the possibility not to cooperate diligently in the nomination process, and may thereby destroy the efficiency of the dispute settlement procedure.

For such cases UNCITRAL in Vienna has devised the so called, UNCITRAL Arbitration Rules. If the parties wish to provide for an ad hoc arbitration procedure, it may be advisable that they provide in the arbitration clause that the dispute shall be settled in accordance with the UNCITRAL Arbitration Rules. In order to facilitate the

nomination of arbitrators, the parties may also wish to provide in the arbitration clause an "appointing authority" which shall appoint arbitrators, if one of the parties does not cooperate in the nomination procedure. However, even if no appointing authority has been named by the parties, UNCITRAL Arbitration Rules have a solution. In such cases the Secretary General of the Permanent Court of Arbitration at The Hague shall designate the appointing authority.

As stated hereinabove, parties may also freely choose the applicable law according to which their contract shall be interpreted. Their choice may relate to the procedural law and/or to the substantive (material) laws alike. However, parties are often not allowed to deviate from the mandatory laws of their own countries. For example, if a national legal system provides that a certain type of contract has to be approved by a national authority before it enters into force, it is almost certain that the contract will be void and will have no effect in the country where such conditions are imposed. Therefore, even when the parties have made a choice of another legal system, they still are bound by the mandatory rules of their own national legal systems.

International JVAs, as a rule, provide for international arbitration, and not for dispute settlement procedure before national courts.

Execution and enforcement of arbitral awards

When parties to a contract agree on a dispute settlement procedure by either agreeing on an arbitration or on

jurisdiction of foreign courts, they will, once they obtain the arbitral award or a final court judgment, be faced with the problem of execution of such a decision in the national courts of the country where the losing party has its seat.

Foreign arbitral awards or court judgments can be enforced only through local courts in the same way as judgments of local courts. In most countries in the World, local codes of procedure or similar codes, contain rules for enforcement of foreign arbitral awards and judgments of foreign courts. That means, that parties who won their disputes abroad will have to apply to local courts to enforce such decisions in the country where the losing party has its seat and that such enforcements will have to be carried out in accordance with the procedure for such enforcement as contained in national codes.

In order to unify the principles and conditions under which a foreign award or a judgment may be enforced in local courts, the so called New York Convention of 1958 has been signed and ratified by more than 50 countries. This Convention provides only a few grounds on which enforcement of a foreign arbitral award may be refused by local courts. Such reasons are few and explicitly enumerated.

Recently (1985), UNCITRAL has worked out a Model Law on International Commercial Arbitration which was aimed to serve as a model to national legislators when drafting provisions of their own codes providing for such arbitration. The Model Law repeats the grounds on which recognition or enforcement of a foreign arbitral award may be

refused under the New York Convention. In this way, if many countries would incorporate the Model Law into their national legal systems, even a greater degree of unification could be achieved than it exists today through the New York Convention.

TRANSFER OF TECHNOLOGY

One of the advantages of joint ventures as they are often conceived in todays' practice, is that they involve also a transfer of technology package. As a matter of fact, many JVAs are established exactly because the partners from developing countries needed modern technology in order to set up a competitive and profitable industrial undertaking.

It would go beyond the scope of this paper to elaborate in detail all the problems of conclusion of technology transfer agreements. However, it may be useful to indicate what types of transfer of technology agreements there are and which of them are likely to be included in a transfer of technology package.

The basic contractual structure in the practice of JVAs is such that transfer of technology agreements represent independent agreements, but which are concluded at the same time with the JVA, and which are often considered as being part of the JVA. They are independent as far as the rights and obligations of the parties from such agreements

are concerned, but their duration is, in principle and very often, limited to the duration of the JVA.

The following types of transfer of technology agreements can be mentioned:

Know-how license agreements, which give the right to the Licensee (local joint venture partner) to use the know-how information put at its disposal by the Licensor (foreign joint venture partner). Know-how is such knowledge which is not protected by patents or trade marks or other legal instruments and which, therefore, contains confidential information not generally known to anybody but to the Licensor. Since the knowledge (know-how) is not protected it must be kept confidential by the Licensee. Know-how agreements are the most commonly used license agreements.

Patent license agreements, which give the right to the Licensee to use a patent. A patent is a legally protected right to use an invention which has been duly registered and for which a patent has been issued or applied for.

Supply of technical information agreements, on the basis of which the Licensor shall supply to the Licensee drawings or other constructional data, list of equipment needed to arrive at an optimum efficiency of the process or plant, specifications of the measuring instruments best suited for the most efficient system for local production, general descriptions of the assembly, manufacturing, production etc. of a certain product, circuit diagrams, and/or other information.

Trademark license agreements, on the basis of which the Licensor gives the right to the Licensee to use a certain trademark for a certain product and reserves for himself the right to control the quality of such product. Trademark may be a word, a mark or a phrase for which the law has given the owner a right to exclude others from using it.

A license may be an exclusive license in which case the Licensor grants the licensee the sole right to practice the license (patent, know-how, trademark, etc.) to the exclusion of the Licensor and others on a certain territory, in a certain field, product or time. Normally such exclusive license contains the right to license others. A sole license means that Licensor grants the Licensee an exclusive license except for the retained non-exclusive license of the Licensor.

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