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JOINT VENTURES

Introduction

"Joint venture" is a term used to describe a form of international long-term co-operation, 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 co-operation.

One of the characteristics of international economic relations is that, from time to time, they create new forms of international co-operation 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 wide use 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 co-operation 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 co-operation 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 co-operation, 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 know 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 co-operation, has shown itself to be a very resilient instrument. In spite of all the criticism and doubts, in the field of international economic co-operation, 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 co-operation, like for example, licensing, long-term industrial co-operation, 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 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 practices. 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 arrangement 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 long-term arrangement. 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 co-operation in four different aspects, namely:

(1) in the partnership aspect;
(2) in the incorporation aspect of the whole arrangement;
(3) in the field of transfer of technology; and
(4) in the field of services which one partner may undertake for the joint venture.

Joint ventures in the area of foreign investments, imply most often 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 practiced 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 co-operation knows several distinct types of foreign trade contracts. Such contracts may be in the field of international trade, international construction, international long-term industrial co-operation, foreign investment, transfer of technology, 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:

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 of 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 40 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 the national contract laws or codes.

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 domestic 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.

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.

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.

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.

Other Laws and Regulations

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

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 a 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 for 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 increasing 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 entrepreneurial skill and potential;
- increased employment potential and increase in employment

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.

Recnet 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 ownership 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 form of doing business and to the relative inexperience of negotiators from developing countries in negotiating such contracts, in the 1960-ies and 1970-ies it became more and more usual that these types of contracts were more and more regulated by local laws and regulations. In order to protect their nationals from experienced trans-national corporations, many 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 often applied and requested through such contracts, developing countries started to regulate through their own laws principles of such contracts, too.

As a result of regulatory practices, it became usual that JVA, as well as transfer of technology agreements, were 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 contained basic principles and conditions under which a foreign investment can be made as well as conditions for conclusion of transfer of technology agreements.

Although there is a great number of countries which permit foreign investments and joint venture agreements, these type of 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 benefitted from increased influx of foreign capital and technology.

However, in more recent years, due to lack of loan capital, a trend toward softening of the conditions and requirements for such contracts has been noted even in countries which had a restrictive approach toward foreign investments. Foreign investment laws of many developing countries contain more and more incentives for foreign investors, while the transfer of technology laws started to have less severe conditions for such agreements.

This trend started in the late 80-ties and early 90-ties. As a result of the lack of aid and loan capital and of other favorable sources of financing, many developing countries started again to attract foreign investments by liberalizing their laws and relinquishing earlier legal constraints. Many developing countries have revised their foreign investment laws and made them more attractive to foreign investors. This is particularly true in former socialist countries, which have traditionally looked with suspicion on joint ventures. Many of these countries have radically changed their political system and consequently liberalized their foreign investment laws. Fully foreign owned investments are again on the rise and majority foreign ownership is more often a rule than an exception.

The process of privatization has also made an impact on foreign investments, particularly in earlier socialist countries. These countries have decided to transform quickly the whole ownership structure of their enterprises by selling public enterprises to domestic and foreign interests. These developments have contributed to a substantial change in the foreign investment climate in the World today.