International Business Law

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JOINT VENTURE

INTRODUCTION

What does the term "Joint Venture" stand for?

"**Joint Venture**" is not a strict legal term, but a description of a certain business relation.

The term describes a business situation **where 2 or more parties join their capacities in order to achieve a certain common objective with a benefit for every party** and mostly over a long period of time.

Joint ventures have become an important strategic option for many businesses. Due to increased globalisation, the proliferation of modern technology as the means of conducting business, and increased international travel, businesses are now operating in a world without borders, albeit that there are still cultural and language issues. This guide summarises the key considerations in establishing a joint venture or other strategic partnership.

The term 'joint venture' is an umbrella term which describes the commercial arrangement between two or more economically independent entities.

In practice, the legal form of a joint venture is likely to be determined by a number of factors including the nature and size of enterprise, the anticipated length of the venture, the identity and location of the venturers and the commercial and financial objectives of the participants.

While the CONTRACT tends to realize an EXCHANGE between the parties

In the JOINT VENTURE the emphasis is put on the COOPERATION among the parties

Alliances

- Joint Ventures are often called “alliances” or “matrimony of companies”.

Goals

- This alliance is made to achieve results that the parties could not or did not want to achieve alone.

Type of alliances

- such an alliance may take place between:

“friends”

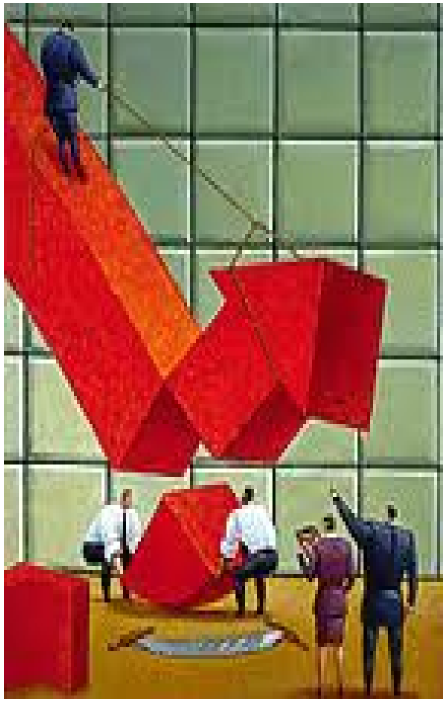
market competitors

Joint Venture performed with “friends”

- the new Joint Venture Company mostly appears on the market and sells new products.

Joint Venture with market competitors

- the parties often try to reduce costs on research or development by establishing a joint venture company, so that it would not appear on the market.
- Such costs could be divided among the Joint Venture parties



The parties always hope to save money and time by unifying their capacities to achieve a common target and profit both

Negative aspects of the Joint Venture

The main disadvantage is the loss of autonomy of the parties.

The decisions concerning the Joint Venture must always be made in consent with the other party, which means that this party has to be chosen carefully.

Furthermore a party might feel tied to the JV, as it can hardly contract with other parties or work autonomously on the same market that is covered by the JV.

Characteristic elements of JV

There is a common target, that the parties want to achieve by cooperation in order to make a common benefit.

For that reason the parties unify resources and capacities.

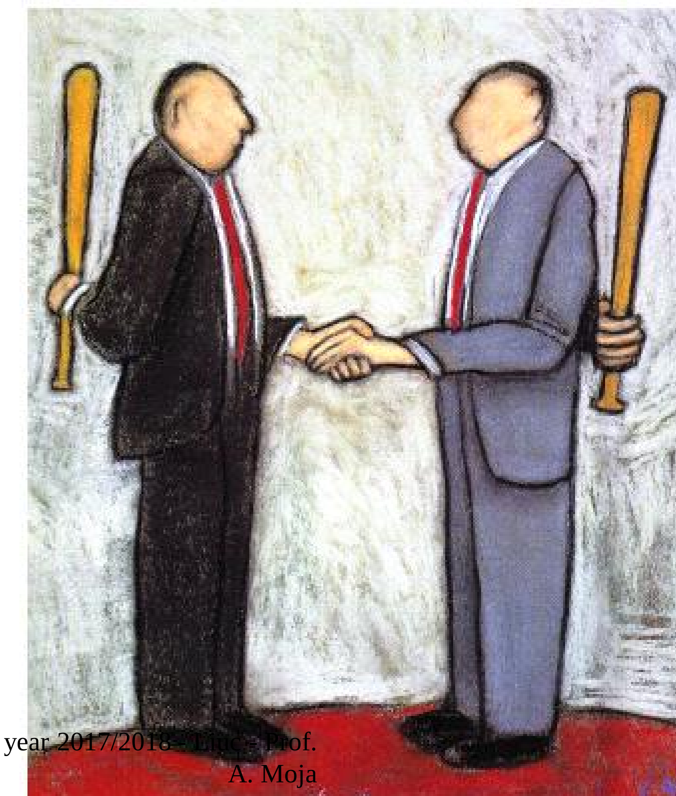
Every partner has the possibility to participate in the administration of the JV

Costs, risks and profits are attributed to the parties almost in adequate shares.

There is generally an obligation of non-competition among the parties and between the parties and the JV company

There must be balance between risks and limitation of autonomy on one side and the profits on the other side.

NEGOTIATION PHASE



The Parties, in the determination of the content of the Joint Venture, have to pass through a negotiation phase, as follows:

as the Joint Venture is a complex business, that involves high investment costs and generally a long period of time, there will be the need for substantial resources and other capacities


fiscal conditions
market conditions
THE PARTIES SHALL DEAL WITH
legal rules
banking systems

CHOOSING A PARTNER

The JV partner must have the right capacities and resources

He must be willing to accept cooperation for a longer time and a certain loss of autonomy.

As the parties want to achieve a common target, there is no sense in weakening the other party and protecting own rights – cooperation is the basis.

Every party has to make sure to avoid dominance from the other party by introducing clauses that secure a certain control on the administration of the JV (right to approve contracts, right to resolve cooperation,…).

Verify feasibility

Then the parties have to verify the economic, technical and commercial feasibility of the JV.

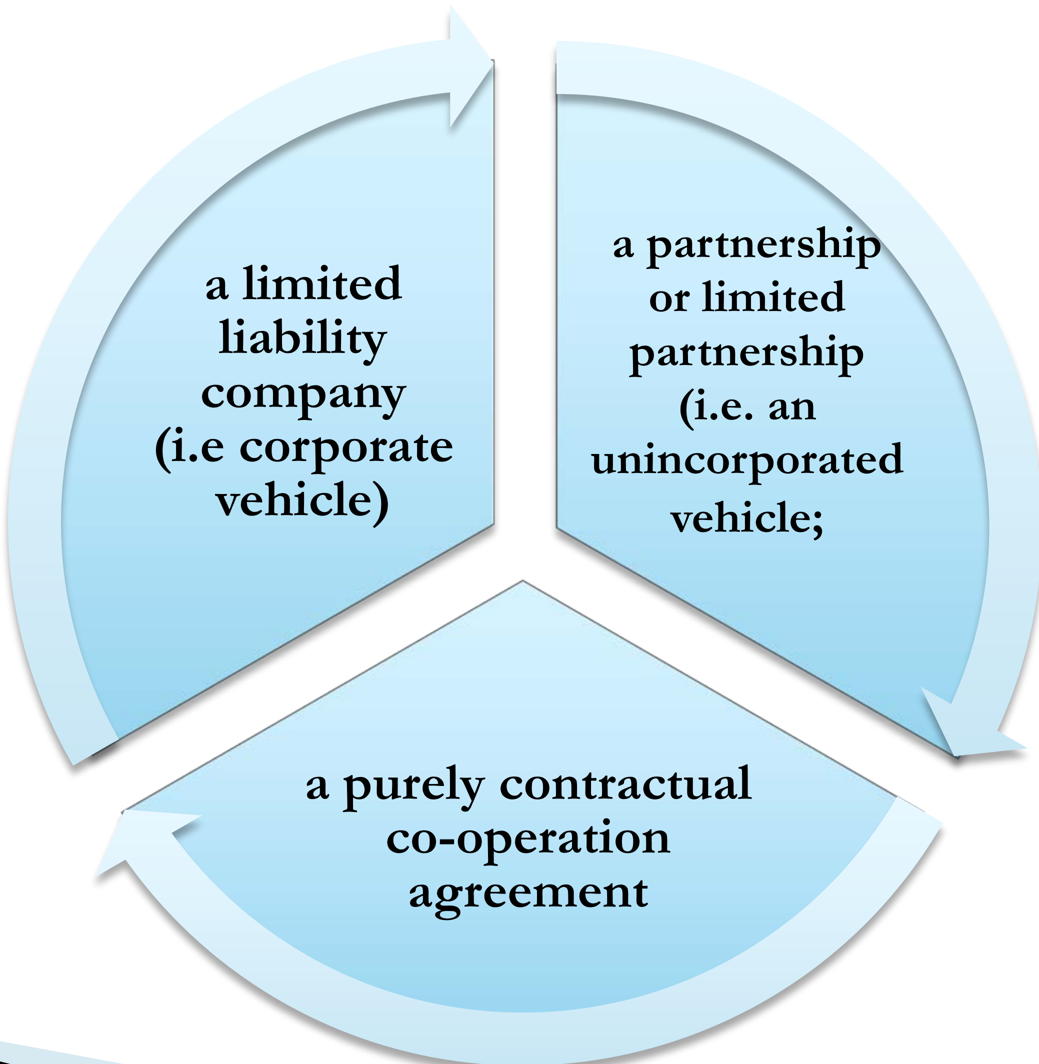
These feasibility studies are based on assumptions about the market and principally regard the financial burdens of constituting the JV and positioning it on the market.

At the same time they provide the basis for the legal structure of the JV

It must be examined the market status of competitors and result in the determination of the size and form of the JV.

The feasibility studies are often accompanied by letters of intent and confidentiality agreements.

Three basic legal structures can be used for joint venture, these being:



PARTNERSHIP

A partnership is the relation which subsists between persons carrying on a business in common with a view to a profit.
There are also certain "hybrid" vehicles or arrangements, such as a limited liability partnership, with characteristics from more than one of the above categories.

In any case people are getting used to distinguish 2 main different ways to set up a Joint Venture

- **by contract** → **Contractual Joint Venture**
- **by establishing a company** → **Equity Joint Venture**

Contractual Joint Venture

the cooperation of the parties is ruled by a series of contracts.

Equity Joint Venture

the parties cooperate via a new company, of which both parties are shareholders

Both forms (i.e. contractual and equity J.V.) require different solutions for similar problems, such as:

attribution of investment costs, attribution of controlling powers, distribution of risks and profits, dissolution of the JV.

Each form is more suitable for a certain business target

CONTRACTUAL JOINT VENTURE

The relation is easier to dissolve. The cooperation is generally dissolved when the target is achieved.

The relationship is more flexible and does not have such a high impact on the organisation of the parties involved as a JVC. It does not create a third legal person.

There is mostly a single, individual target. (e.g.: An international contract for work)

Fiscal effects: All taxes are attributed to the parties of the contract.

The duration of the cooperation is shorter.

EQUITY JOINT VENTURE

Fiscal effects: Taxes are attributed to the new company.

There is a common target, mostly not a single one, but a general, wide objective (common development and distribution of a certain product).

The cooperation is planned for a long period of time

As a new company must be established it needs high investment costs and has a huge impact on the organisation of the parties

The parties do not intend to dissolve the relation, if not in case of insuperable differences or conflicts between the parties.

A JVC has its own representatives, which makes it easier for the parties to coordinate control and other activities

It lays out the objectives for which the JVC shall be constituted.

It provides rules for the constitution itself and the relation between the contracting parties and the JVC

It rules who is responsible for the administration and representation of the new JVC.

It states the duration of the JVC and some solutions for possible disputes

PURPOSES OF THE AGREEMENT

The objectives determine the targets of the JV; what it was constituted for.

They show what the future should bring. The purpose of this Agreement is to provide for the establishment, ownership and operation by the Parties of the New Company, which shall be the exclusive vehicle of the Parties for the manufacturing, marketing and sale of Commercial Products and Components in the Territory and the supplying of technical assistance and service in relation thereto

DISSOLUTION OF THE JOINT VENTURE

The JV can survive or it can be dissolved

IN CASE IT SURVISES: one party leaves the JVC, if it is profitable and the other party wants to continue work.

This is often made by granting put or call options to the remaining or leaving part

THE DISSOLUTION often results in its liquidation in cases of hardship or deadlock, as also ruled out by law in many jurisdictions.

DEADLOCK

This reference stands for a standstill resulting from the opposition of two unrelenting forces or factions.

Deadlock can arise either in a 50/50 joint venture where the shareholders' appointed directors take opposing views or where a director appointed by a minority shareholder exercises the right to veto.

Similarly, deadlock can arise at shareholder level in relation to matters which require shareholder approval.

It is helpful to have a policy to revert to when an insoluble deadlock arises. The aim of the policy should be to ensure that a sensible compromise is reached before the deadlock occurs.

When there is an insoluble deadlock, the following options are usually available:

<u>Transfer of shares</u> – a deadlock could serve as a trigger leading one party to transfer its shares to a third party subject to pre-emption rights.

<u>Voluntary liquidation</u> – the assets of the venture will be sold and the venturers will share the proceeds according to their equity interest

Furthermore, the JV agreement has to determine the price of the shares. In case of non-performance of one party the price might have a penalizing character.

A situation of dispute can arise in determining the party who has to leave the JV. Especially in cases of deadlock it is not easy to decide which party can stay.

Such a dispute is often solved in an auction procedure (also called Russian roulette) or by the decision that the minority party has to leave.

PUT OPTION

After the occurrence of the Completion and during the continuance of this Agreement, provided that a Termination Event occurs as hereinafter set forth in article ……..without prejudice to any further right to claim for damages, shall have the right to sell its New Company's Shares to NN and NN shall be bound to purchase said Shares, the transfer price being equal to the actual value of the Shares at that time owned by AA as assessed at that time in accordance with the price formula(s) herein referred to in Enclosure <...>.

CHINA

China
Russia
Mongolia
North Korea
South Korea
Beijing
Pak.
Nepal
Bhutan
India
Bangladesh
Myanmar (Burma)
Laos
Vietnam
Thailand
Cambodia
Taiwan
Philippines
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China's market has been growing at an unanticipated speed during the last years.

Alone in the year 2003 some 41.081 foreign companies have invested more than 53 billion $ in China.

The opening to the worldwide market has started in 1979 and has been growing ever since.

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The recent entrance of China to the WTO (2001) has given new incentives for investments – lower customs, elimination of quotas for certain business sections, progressive liberation of the market.

Especially since the early '90s there has been a huge increase in new laws, especially on foreign investments.

Beside the law the *"Foreign Investment Industrial Guidance Catalogue"* is of importance. It lists encouraged, limited and forbidden investments with various consequences for the investments.

JOINT VENTURE IN CHINA

Praxis in China come to distinguish two forms of Joint Ventures:

Equity Joint Venture:
The parties are shareholders of a limited liability company, predetermined by Chinese law

Cooperative Joint Venture:
The parties are free to choose between establishing a company (not Equity Joint Venture but any other Chinese company with limited liability) or not creating any new legal person and determine the cooperation by contracts.

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EQUITY JOINT VENTURE

A limited liability company, according to Chinese law, of which a minimum of 25% is held by a foreign investor (but never more than 99%).

The business praxis has established the rule that there must be a minimum capital of 1.000.000 RMP (€110.000).

Such an Equity Joint Venture has a duration of 10 to 20 years by law. It can be extended by another 10 to 20 years afterwards.

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Procedure
of constituting
an equity joint venture

1. **Finding business partner**
2. **Preliminary negotiation – letter of intent**
3. **Feasibility study**
4. **Joint Venture agreement**
5. **Approval by MOFCOM (Ministry of Commerce)**
6. **Registration by SAIC (State Administration for Industry and Commerce) in order to gain business licence.**
7. **Successive operations**

1. Finding business partner

- This task can be more difficult than expected, as it is hard to get reliable information on the business partner in China.
- Only few companies have certified balance sheets (state owned companies, very few private companies and companies that are registered at the Shenzhen or Shanghai stock exchange).
- This lack of information is particularly difficult concerning the liquidity and financial status of the partner.

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2. Letter of Intent

- Such a letter defines objectives and steps for the realisation of the Joint Venture before the main agreement is signed and the company established.

- Also if not legally binding (the main contract is signed later), it is of especial importance in China:

Only with a letter of intent (and the feasibility studies), the Chinese partner can apply for the authorisation of further negotiations *(Approval of Project Proposal)*.

3. Feasibility Study

- The feasibility study has to examine the Chinese market and lay out where, how and when the Joint Venture company shall operate.

- It is necessary for the application of the *Approval of Project Proposal* by the Chinese partner.

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4. The main agreement

- The main contract is composed of an agreement and a statute of the new company.
- Both have to be approved by the MOFCOM

Investments and capital

- Special emphasis is laid on the total of investments:
  The law regulates special proportions between investments and capital of the Equity Joint Venture.

- It is necessary to understand that according to Chinese law "investment" includes initial payments and all other payments made after the constitution, which are necessary to achieve the business targets.

- No approval will be given, if the investments seem too low to achieve these targets.

The law prescribes following proportions:

- **Investment less than 3 million $ - capital must be 7/10**
- **Investment between 3 and 10 million $ - capital must be ½**
- **Investments over 30 million $ - capital must be 1/3**
- **Above 36 million $ – capital must be at least 12 million $**

There are also certain time limits for the payment of the investments. At least 15% of the investment sum has to be paid within 90 days after obtaining the business licence. All of the capital has to be paid within 1 to 3 years, depending on the amount.

Investment and capital

- The controls by Chinese authorities (SAIC) of these time and money limits have increased in the last years and have forced many Joint Venture companies into liquidation.
- This problem is increased by the ways of valuation by the SAIC of non-cash attributions of the shareholders, such as intellectual property, machines, ….
- The authorities would evaluate these contributions "on the spot"
- If they are insufficient, the law provides two solutions:

The parties can pay the missing amount in cash or they ask for a new valuation and resolve the problem between themselves.

Exemption of customs and VAT

- **The laws on tax and customs exemptions for foreign investments always change.**

- **In May 2004 contributions in capital or objects bought for the activity of the JVC, were exempt from VAT and customs if the Joint Venture project is listed in the *"Foreign Investment Industrial Guidance Catalogue"* as an "encouraged project".**

5. Approval by authorities

- The MOFCOM or its local subsidiaries have to authorize the new Joint Venture Company.

- Following documents must be presented in Chinese: Application for constitution of a JV, feasibility study, letter of intent, main agreement, statute of new company, names of president and other managers of the JVC.

- After approval (normally 2 to 3 months, sometimes much quicker, too) the new company must be registered at the SAIC, in order to obtain a Business Licence.

- All modifications (change of shares, transfer of shares, increase of capital, dissolution or liquidation of company) made after this registration, must follow the same procedure.

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Successive and final operations

Within 30 days after registration the company has to be registered in following places:

-Tax offices (state and local)

-Local office for the control of foreign exchange

-Office of financial administration

-Office of labour

-Customs

-Local office for statistic control.

Administration of company

- The Chinese company law gives several rules concerning the administration of the JV company.

- There must be a Board of Directors (also Joint Management Committee), that has to meet at least once a year. There must be at least 3 directors appointed for 4 years.

- In special cases they have to decide unanimously (modification of statute, liquidation of JVC, increase of capital,…)

Cooperative Joint Venture

This term includes two forms of JV:

1. **A JV with a Joint Venture Company, that is not, however, an Equity Joint Venture. It gives more autonomy to the parties to determine their rights and duties, their investments and the duration of the new company.**
2. **A JV that is performed without creating a new legal person, i.e. only by contracts.**

However, all forms of the Cooperative Joint Venture have to be approved by the MOFCOM, too.

An example: investment vehicle in China

Pan Pearl River Delta (PPRD)

- Popularion – 510 million
- Per capita GDP US$ 1,400
- GDP US$ 706 billion
- Contributes 44% of china GDP
- Pan-PRD, widely known as 9+2
  - A newly integrated economic zone made up of the Guangdong, Fujian, Jiangxi, Hunan, Sichuan, Yunnan provinces, Hong Kong and macau Special Administrative Regions.

Comparable to the 10-nation ASEAN in terms of its population, size of economy, toral volume of external trade and intake of foreign investment.

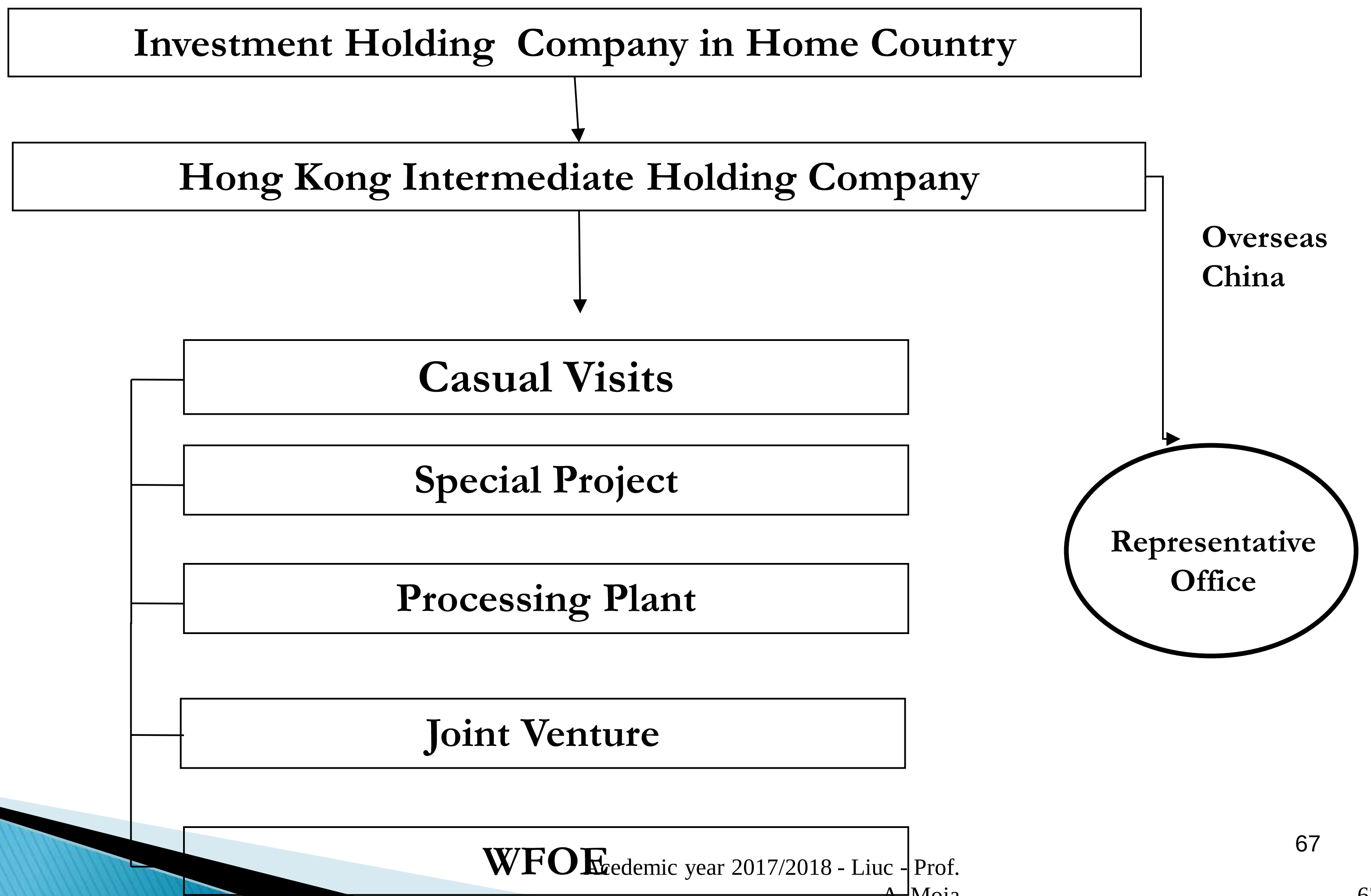
Why PPRD?

Vast area of land, abundant labour supply and natural resources

Huge domestic market and extensive international network

Regional GDP is forecast to exceed US 1,000 billion by 2010 and reach US 2,000 billion by 2020

Framework of Strategies for investment in China



Joint Ventures (JV)

Cooperative JV

Equity JV

Wholly Foreign-Owned enterprioses (WFOE)

- Manufacturing
- Servicing
- Trading - FICE

Setting up a WFOE

Minimun capital requirement

- Servicing RMB 100,000 (EUR 10,000)
- Manufacturing RMB 500,000 (EUR 50,000)
- FICE RMB 500,000 (EUR 50,000)

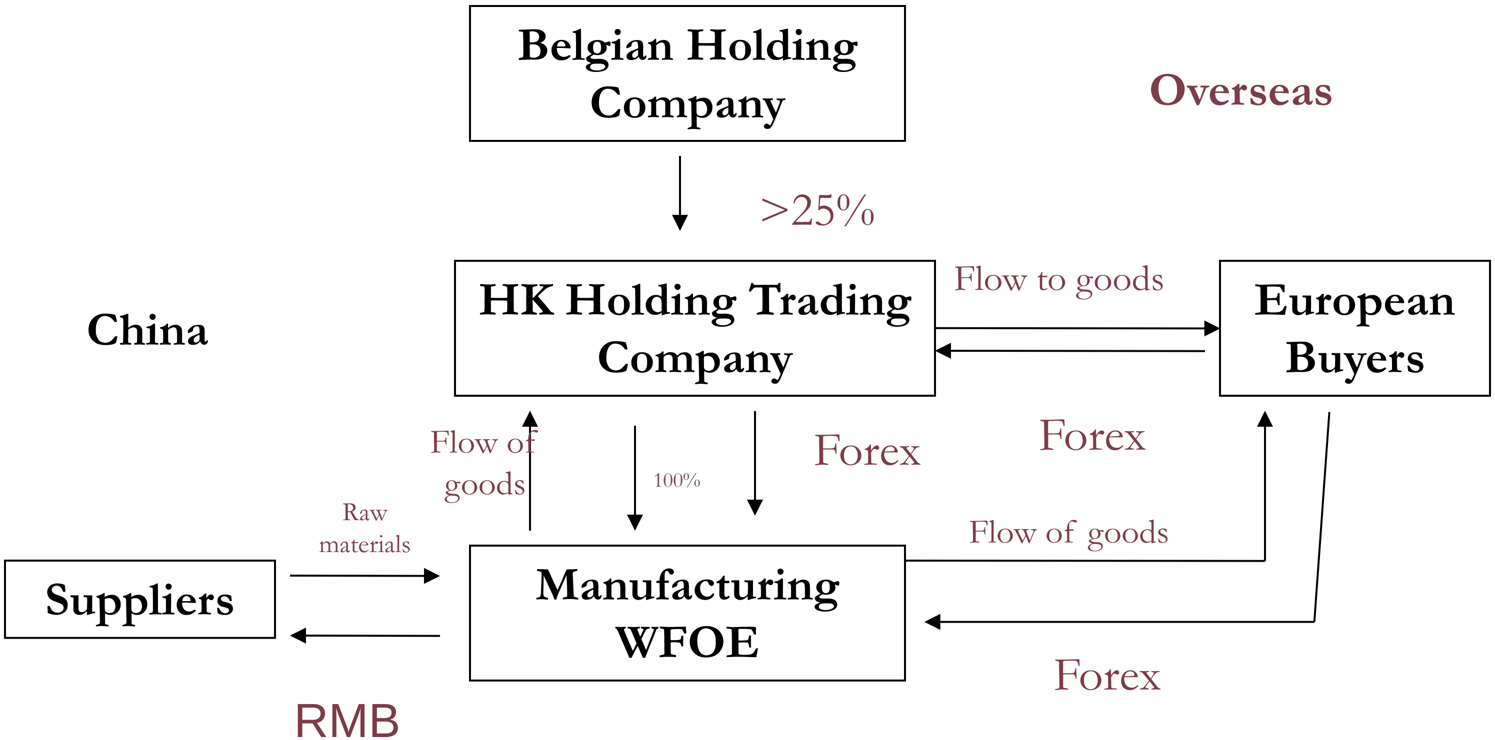
Debt-to.equity rules

Board of Directors 3 – 13

Natural persons and no local director requirement

Chairman of the Board is the legal representative

Manufacturing WFOE
Sell goods to European buyers via HK Trading Co



Tax Incentives for manufacturing WFOE

Tax holiday (first 2 years exempted and next 3 years with 50% concession)

50% concession for SEZ locations

50% concession for Hi-Tech Industries located at specific hi-tech park

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Taxes Applicable to foreign Invested Enterprises

- Income tax
  - Corporate Income Tax
  - Indicual Income Tax

- Turnover Tax:

VAT; Business Tax

Customs Duties

Other Taxes

Progress of common trading vehicles in China

FOREIGN TRADING COMPANY
MANUFACTURING WFOE
PROCUREMENT CENTRE
FREE TRADE ZONE TRADING COMPANY

↓

FOREIGN INVESTMENT COMMERCIAL ENTERPRISE FICE

JOINT VENTURE IN SOUTH AMERICA AND RUSSIA

General Principles

It is also preferable having the share capital split between the shareholders in the following way: 49% - 51%.

It should be better to rule the shareholders' relationship by means of deadlock clauses in order to sort out deadlock events whenever they should occur.

JOINT VENTURE IN SOUTH AMERICA


VENEZUELA
GUYANA
SURINAME
FR. GUIANA
COLOMBIA
PERU
ECUADOR
BRAZIL
BOLIVIA
PARAGUAY
ARGENTINA
CHILE
URUGUAY

THE SPANISH HOLDING

Resident in a white list country

SHAREHOLDER

Resident in a white list country

SHAREHOLDER

Dividends:
0%

SPANISH HOLDING

FISCAL EXEMPTION
Both for dividends and capital gains

Dividends:
- 0% withholding tax
(with European Directive mother-daughter)

Capital Gains:
No taxation in connection to the subsidiaries

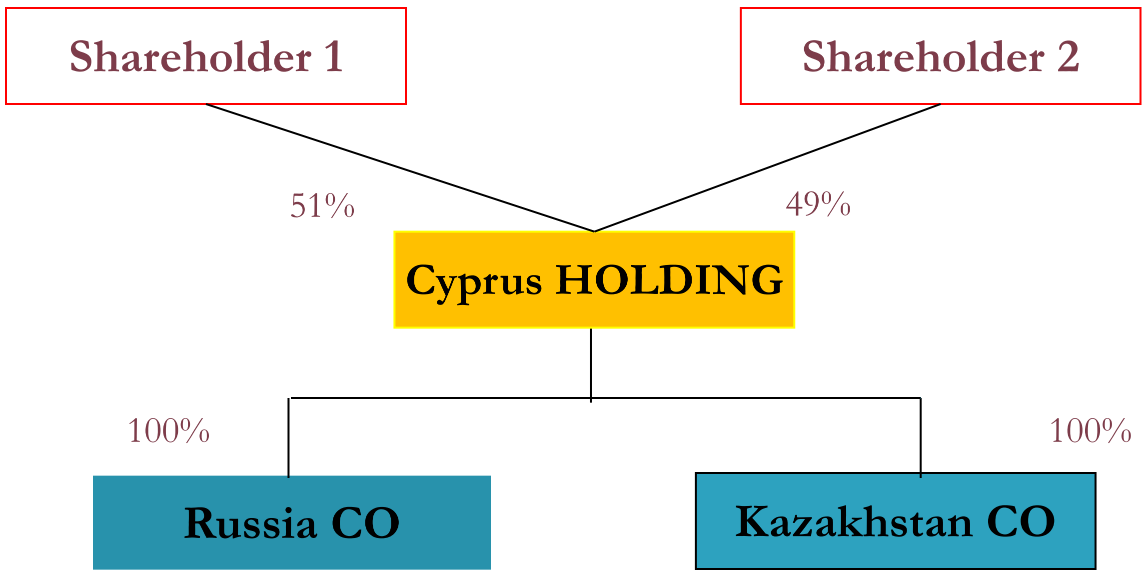
SUBSIDIARY A
ARGENTINA

SUBSIDIARY B
VENEZUELA

JOINT VENTURE IN RUSSIA


Russia
International boundary
Railroad
National capital
Road
0 250 500 750 Kilometers
0 250 500 750 Miles
Lambert Conformal Conic Projection, SP 47/62 N
Boundary representation is not necessarily authoritative.
ARCTIC OCEAN
NORTH ATLANTIC OCEAN
Norwegian Sea
North Sea
Barents Sea
Kara Sea
Laptev Sea
East Siberian Sea
Chukchi Sea
Bering Sea
Sea of Okhotsk
NORTH PACIFIC OCEAN
Sea of Japan
Yellow Sea
East China Sea
Black Sea
Caspian Sea
Baltic Sea
Arctic Circle
SVALBARD (NORWAY)
FRANZ JOSEF LAND
NOVAYA ZEMLYA
SEVERNAYA ZEMLYA
NEW SIBERIAN ISLANDS
Wrangel Island
KURIL ISLANDS
Sakhalin Island
Occupied by Soviet Union in 1945, administered by Russia, claimed by Japan.
UNITED KINGDOM
NORWAY
SWEDEN
FINLAND
DEN.
GERMANY
POLAND
BELARUS
UKRAINE
ROMANIA
TURKEY
SYRIA
IRAQ
IRAN
SAUDI ARABIA
Kuwait
AZERBAIJAN
KAZAKHSTAN
UZBEKISTAN
TURKMENISTAN
KYRGYZSTAN
TAJ.
AFGHANISTAN
PAK.
CHINA
MONGOLIA
NORTH KOREA
SOUTH KOREA
JAPAN
U.S.
Moscow
St. Petersburg
Murmansk
Arkhangel'sk
Vorkuta
Salekhard
Nadym
Noril'sk
Igarka
Dikson
Tiksi
Yakutsk
Magadan
Petropavlovsk-Kamchatskiy
Anadyr'
Pevek
Cherskiy
Provideniya
Okhotsk
Yekaterinburg
Novosibirsk
Omsk
Tomsk
Krasnoyarsk
Irkutsk
Bratsk
Chita
Khabarovsk
Vladivostok
Blagoveshchensk
Yuzhno-Sakhalinsk
Tokyo
Almaty
Bishkek
Tashkent
Baku
Tbilisi
Yerevan
Tehran
Ankara
Warsaw
Minsk
Kiev
Riga
Vilnius
Tallinn
Helsinki
Stockholm
Oslo
Copenhagen
Amsterdam
Berlin

STRUCTURE THROUGH A CIPRO HOLDING



INTELLECTUAL PROPERTIES

- In order to manage the intellettual property rights there would be two possible solutions:

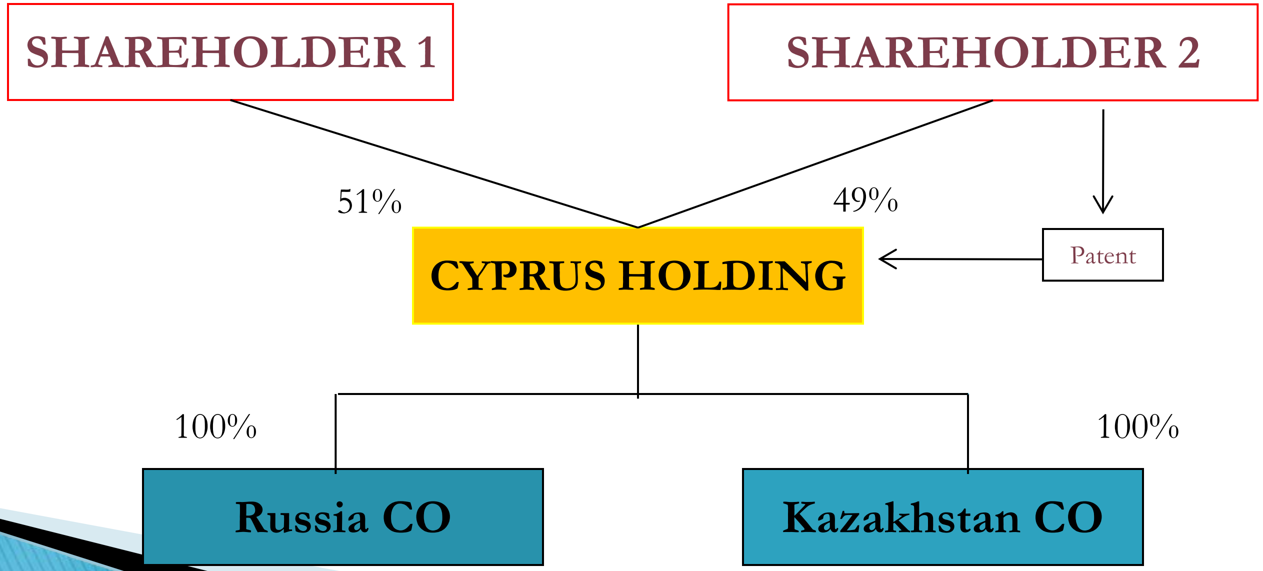
A. the intellectual property rights will be transferred into the JV (at NEWCO level).

B. The intellectual property rights will be ceased by means of a licence agreement from the shareholder, owner of the intellectual property, to the subsidiary of the NEWCO (under NEWCO level).

INTELLECTUAL PROPERTIES

Solution A

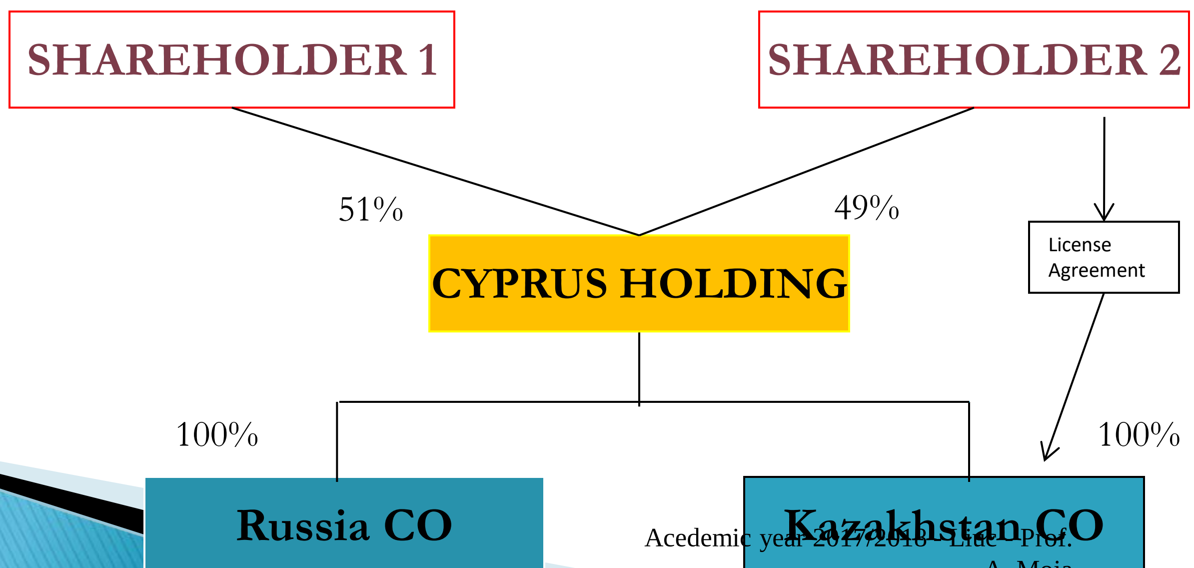
- Shareholder 2 (see below), in its quality of owner of the intellectual property, directly confers it to the NewCo



INTELLECTUAL PROPERTIES

Solution B

- License agreement through which the using of the intellectual property is transferred from shareholder 2 to one of the subsidiary of the NEWCO



JOINT VENTURE IN INDIA

Srinagar
CHINA
Dehra
Dun
PAKISTAN
Delhi
New Delhi
NEPAL
BHU.
Agra
JAISALMER
JAIPUR
Kanpur
Allahabad
Varanasi
BANG.
Ahmadabad
Bhopal
Jabalpur
Calcutta
Dhaka
MYANMAR
Nagpur
Mumbai
(Bombay)
INDIA
Pune
Sholapur
Hyderabad
Vishakhapatnam
Yangon
(Rangoon)
Bay
Of
Bengal
GOA
Bangalore
Chennai
(Madras)
Indian
Ocean
Kozhikode
(Calicut)
Coimbatore
Madurai
SRI LANKA
70°

Features of JV	Type of JV
Content of JV	• Procurement JV • Research and Development JV • Distribution JV • Service JV • Joint Venture with several or all value creating phases
Number of Partners	• 2 Partner (Dual JV) • More then 2 Partners (Multyparty JV)
Origin of Partners	• Both come from same country of origin • Partners come from different countries and make a JV in India • Partner comes from overseas and India
Degree of Participation	• Majority Joint Venture • Equity Joint Venture (50:50) • Minority Joint Venture
Time of JV	• Short Term (Project Based, e.g. 5 years) • Long Term (More then 10 years)
Nature of JV	• Free choice • Government Regulations (e.g. Maximum 49% FDI allowed)