

JOINT VENTURE AGREEMENT

Joint ventures - an art

Cross-border alliances between corporations are a fact of modern business. Some alliances are no more than fleeting encounters lasting only as long as it takes one partner to establish a presence in a new market while others are a prelude to a merger of the technologies and capabilities of two companies. Whatever may be the duration or the objectives of various alliances, being a good partner has become an important asset for any corporation. This is particularly relevant in the global context where the ability to create and sustain collaborations is vital in companies obtaining a significant competitive advantage.

However, it has been seen that too often companies devote more time to screening potential partners in financial terms rather than in managing the partnership in human terms. More attention is paid to controlling the relationship than about nurturing it. Joint ventures are like marriages - they require trust, honesty, integrity, communication, care and vision if the alliance is to last for the long-term. The scope for collaboration is strengthened when communication is intensive and the relationship is more family-like rather than rational. It is generally observed by various studies that North American companies are more concerned with the economics of the deal and frequently neglect the human aspects. On the other hand Asian companies appear to be more adept at dealing with inter-personal relationships.

Of course, both partners must be in a win-win situation. To highlight the personal side of business relationships is not to deny the importance of sound financial and strategic analysis.

The need for joint ventures

In today's world, many projects are too large for any one company to undertake as it may involve huge financial commitments - this is especially true in the infrastructure area. Market access is another reason for the international proliferation of joint ventures. Conducting research is another area where the risks need to be shared. Joint ventures must yield benefits for both partners, but more importantly they should offer the parties an option to implement their vision for the future and exploit unforeseen opportunities.

Alliances are of special relevance in emerging markets such as India, as these markets come out of their self-imposed isolation and insulation from external world markets and move towards a relatively open and competitive business environment. Indian-owned businesses in recent years have realized their inadequacies in terms of products, technology, infrastructure and even management processes. On the other hand, several multinational companies find themselves ill equipped to latch on to market opportunities due to lack of local knowledge and inadequate distribution network. Alliances between those possessing different skills and strengths in technology, marketing and distribution, etc. have become not only desirable but necessary.

While the process of forming these alliances calls for skilled negotiators and planners, the challenge lies in managing and making the alliance work. It is of critical importance that the professional drafter of the agreements must be involved not only at the negotiations stage but also at the stage when the business plans are discussed between the two potential partners.

Nature of a joint venture

Joint ventures may be either contractual or structural, or both. They may be broad based or narrowly defined. Long-term joint ventures, particularly broad based are best suited for a corporate structure. Corporate joint ventures are characterized by shared ownership and often shared functions such as research and development, manufacture, assembly or marketing. Shared ownership leads to shared governance and shared dependency.

The success of joint ventures is built on:

- a common strategic vision shared by the parties;
- a strong commitment to each other and to the joint venture; and
- providing business contributions by the parties that are complementary.

The stages of establishing a joint venture

Selection of partner

Upon identifying a business opportunity it is most essential to select an appropriate partner and open up a dialogue to explore mutual interest without any firm commitment. The selection process of partners can be based on some of the following characteristics:

- (i) long term commitment to the industry, country and venture;
- (ii) the value added by the parties should be complementary. For example, the local partner may have knowledge of the local market, business contacts, distribution network, whereas the overseas partner may have the technical expertise, product range, trade marks, capital and management techniques. Each partner may be given appropriate recognition for the strength and facilities they bring to the alliance;
- (iii) experience in own area of expertise;
- (iv) adequate financial strength; and
- (v) strong local market presence.

It may be reiterated that selection of an appropriate joint venture partner is most important as a wrong selection can otherwise break up the joint venture.

The negotiation phase

At this point, the partners should focus not only on the details of the type of joint venture but also on the potential problems in the parties' future relationship. Some of the issues are listed below:

- (i) Agreement over business plans;
- (ii) Probe into the inadequacies and weaknesses of each partner;
- (iii) Adequate documentation - confidentiality agreement, technology transfer, technology licensing, patent or trade mark licensing, supply of machinery etc.;

- (iv) Clear understanding as to what each partner can do, and cannot do, to avoid any misunderstanding later on;
- (v) The extent of ownership of each party in the joint venture;
- (vi) To define the agreed dividend policy;
- (vii) Building of consensus on key problems; and
- (viii) Setting exit barriers for each partner through mutual inter dependence.

Methods of valuing the business and settling the partner's dues in case one of the partners wishes to pull out of the alliance at a later stage.

4.3 The execution phase

This involves putting up the project within the shortest time period. This needs a great deal of team spirit amongst personnel from all the partners. The technical information actually starts flowing at this stage. Disputes may arise on equipment pricing, on quality of assigned staff, technological changes or adaptations found necessary in actual practice, etc. People involved in the tie-up phase should step in and settle the issues quickly and fairly.

The operation phase

This is the time of realization. Market projections may not materialize, product cost overruns may occur, process efficiencies may not be at projected levels and generally performance may lag behind expectations. This calls for a high level of maturity at the senior most levels. Much needed visionary perspectives should be brought about to bring solutions.

The maturity phase

Although many alliances are open ended when they are set up, very few can ever be perennial and for all time. A key initiative for sustained and continued alliance is to update and modify the alliance contents and take note of changing market requirements.

Documentation

The most important document is a Joint Venture (JV) agreement or a Shareholders (SH) agreement. Essentially a JV or SH agreement provides for the method of formation of the JV company and sets out the mutual rights and obligations of parties for the purposes of conducting the JV and the manner in which the parties will conduct themselves in operating and managing the JV company. The JV agreement is between partners and does not bind the company unless it is included in the Articles of Association. This has been well established by the Supreme Court decision in the leading case of *V.B. Rangaraj vs. V.B. Gopalkrishnan and Others* 73 Comp Cas 201 (SC) (1992).

An illustrative list of major clauses usually incorporated in a JV agreement are briefly discussed below:

(a) Parties to JV agreement

The overseas company that is the original party (MNC or a company with well established brand names) may not be the actual investor in the Joint Venture. In order to bind the original overseas company (which may be the parent company or holding company or a sister concern of the investing company) to the agreement, it should be made a party to the JV agreement in addition to the investing parties.

(b) Business objects and products of the joint venture

This clause is probably one of the most important clauses of the entire agreement as it spells out the business to be carried on in all its breadth and depth as well as the territory in which it is proposed to be carried on. A very narrow definition may allow one party to enter into a backward or forward integrated project on its own. For example, the clause may state that the business of the JV company shall be the “manufacture of milk chocolates”. However, in later years one party may start on its own the manufacture of confectioneries that are not milk chocolates after having gained experience of the Indian distribution system. This may never have been the intention of the other party. Thus, the language of this clause must be precise and accurate. The technical details of the product to be manufactured may also be defined. It may also provide for expansion in the range of business in future.

(c) Formation of JV Company

This clause lays down the method of formation of the JV company by registering a new company under the Companies Act or by converting an existing company into a JV company. It also spells out the details as to which party is responsible for the formation of the company and obtaining the regulatory approvals for the proposed venture including the method or manner of sharing these costs and obligations.

(d) Registered office

This clause states the location of the JV business and the registered office of the company, both of which may be at the same place, or at different places. The availability of special incentives and facilities may depend on the location of the operations.

(e) Equity participation by local and foreign investors

The extent of shareholding of each of the local and foreign Investors is defined in this clause and the consideration to be brought in by each of them is spelt out. The share capital may be allotted in an agreed ratio by injecting cash or by bringing in infrastructure facilities, services and assets such as land, building, technology, patents, trademarks, distribution network, goodwill, plant and machinery, etc.

(f) Finance arrangements

This clause refers to the business plan and the manner of raising the finance as stated therein. It also provides whether any of the parties is required to give guarantees for raising the finance. Further, it provides for the role each party should play in raising finance in the stage of expansion of the JV as mutually agreed by the parties.

(g) Specific obligations

This clause details the specific obligations each party undertakes to fulfill for the running of the JV company, for example,

(i) grant of technical assistance and know-how;

- (ii) grant of license to use trademark, patent, copyright, etc.;
- (iii) providing the facility of established distribution channels;
- (iv) access to research, innovation, and product improvements;
- (v) providing marketing expertise;
- (vi) providing management services.

Separate agreements may be entered into between the respective parties and the JV company for some of the above obligations.

(h) Agreement as to future issue of capital

This clause sets out the ratios and terms upon which the parties would subscribe to further issue of share capital and the consideration that they would pay. This should also provide for a situation where one of the parties is unable to bring in more funds due to a variety of reasons including a situation where the JV company is making losses requiring continuing financial strain on the resources of the partners in order for the JV to become successful.

(i) Appointment of directors

This clause sets out the initial composition of the Board of Directors, representation on the Board of each of the parties, the manner in which the directors are appointed to the Board, whether the directors are liable for retirement by rotation, the composition of the Board in the event of change in the pattern of shareholding, provisions for alternate directors, naming of the managing director and the Chairman, remuneration, etc. It is not always necessary that the Managing Director is representative of the majority partner. JVs are based on a balance of power rather than on the dominance by any one partner. It also states whether the Chairman has a casting vote.

(j) Conduct of the affairs of the JV Company

This clause includes the following:

- (i) Frequency of Board meetings
- (ii) Notice
- (iii) Agenda
- (iv) Quorum
- (v) General Meetings
- (vi) Circular Resolutions
- (vii) Accounting
- (viii) Audit
- (ix) Unanimous consent of all JV parties for certain decisions become necessary in circumstances where the JV partners do not have equal ownership and control (please refer Enclosure for illustrative list).
- (k) *Transfer pricing and buy/sell agreements*

This clause spells out the transfer pricing policy in cases where the JV company buys raw materials, components, parts, semi finished products or intermediaries from the JV partners, or sells finished products in a buy-back arrangement. The minimum quantity and price may be spelt out.

(l) *Share transfers*

A joint venture is like a marriage - as described above. It is normally provided that both parties can terminate the JV agreement only on occurrence of certain events. Consequently, no party shall sell, charge, gift, transfer or otherwise dispose of all or part of their shares or beneficial rights. In case there is a termination of the agreement, this clause provides the manner of share transfer. In general, the party disposing of its shares is under an obligation to transfer its shares to the other party. This eliminates the risk of an unacceptable third party such as a competitor from taking over a substantial interest in the JV company to

the detriment of the JV's business. In the event that the other party refuses to buy the shares, the seller may offer the shares to a third party but not at a price below the one offered to the other party. The method of valuation to determine the price of the shares and the valuer's name/s may be also mentioned to avoid conflicts at the time of share transfer.

(m) Distribution / Dividend Policy

The parties may agree upon the profits distribution pattern and accumulation of profits so as to build up reserves. Tax aspects of all the parties may be one of the important considerations in deciding upon a dividend policy.

(n) Name/ Brand licensing agreement

In many cases, the name of one of the parties or the brand name of their product enjoys considerable goodwill and reputation. Such party may agree to permit the use of its name or the brand name of its product by the JV company. The JV agreement would record the terms and conditions of such use and the obligations of the parties in respect of the use of the name by providing for a separate agreement "name licensing agreement" to be entered into between the JV company (when incorporated) and the party whose name is being used.

(o) Research and Development - Improvement and Innovation

This clause provides for the method in which the JV company will benefit from any research and development and improvements and innovations carried out by any one of the parties to the agreement. It also sets out the procedure for giving reverse benefit to the parties to the agreement if the JV company conducts any research or develops any improvement or innovation.

(p) Non-competition provisions

This clause records the agreement between the parties not to carry on competing business to that of the JV company. In particular, it may state that :

- (i) both parties will undertake manufacturing or marketing only through the JV company and not permit the use of know-how to any other person in the defined territory

- (ii) no other entity owed or controlled by the parties shall canvass or entice away any employee of the JV company
- (iii) no party shall carry on similar business for an agreed period after termination.
- (q) *Confidentiality/ Secrecy*

The agreement between the parties to maintain secrecy of information relating to the technical process, business, know-how and other business information that is not already in public domain is recorded in this clause. The parties may also provide that they will ensure that their employees will also be bound by this clause. In addition, it may be provided that the obligation of confidentiality and secrecy is maintained at all times notwithstanding the termination of the JV for any reason.

(r) *Period of agreement*

This clause stipulates the period for which the JV agreement would remain in force so as to bind the parties together. It gives the effective date of the agreement as the starting point. It also provides for renewal of the agreement after the initial period and the circumstances and terms and conditions of such renewal.

(s) *Termination*

This clause sets out the events and circumstances under which the JV agreement is terminated. Some of the events are:

- (i) Mutual agreement of the parties, e.g. resulting from fundamental disagreement or deadlock over a variety of issues, including changing the scope of JV or an increase in capital contribution;
- (ii) One of the parties not holding any shares in the JV company;
- (iii) Material breach by one of the parties of their obligations under the agreement;

- (iv) Insolvency, bankruptcy or liquidation of any one of the parties;
- (v) Change in laws resulting in non-performance of the terms of the agreement.

The clause also provides for the obligations of each of the parties towards each other in the event of termination of the agreement.

(t) Force Majeure

This clause provides protection to a party confronted with events beyond its control which disable any party from performing its obligations under the JV agreement.

(u) Bearing of pre-operative expenses / costs

The manner and proportion of bearing of expenses incurred by the parties prior to entering into the JV agreement are detailed in this clause. It also provides for bearing of expenses in case the JV does not materialize despite entering into an agreement.

(v) Arbitration

In the event that the parties are unable to resolve a dispute through negotiated settlement or through alternative dispute resolution methods, a provision for arbitration is required as the last alternative to litigation in Court. An agreement to arbitrate provides for a forum other than a Court of Law so that disputes may be resolved expeditiously. It also provides for the values and law of arbitration to be applicable as also the method of appointing an arbitrator(s) and the competent jurisdiction in which the arbitration award is to be entered.

(w) Governing law

This clause stipulates the system of law by which the agreement is to be incorporated and enforced. In case of foreign inward investment, Indian Government requires that the applicable law should be the Indian law.

(x) Assignment

Parties have to agree whether the agreement can be assigned to their successors and nominees.

(y) Precondition

The agreement is expressly subject to the approval of RBI or FIPB and the terms and conditions stipulated by the Reserve Bank of India in their letter of approval are to be made part of this agreement.

(z) Supremacy

This clause provides that in the event of any conflict between the provisions of the JV agreement and the Articles of Association of the JV company the intention of the parties is that the provisions of the JV agreement shall prevail. The parties are required to exercise their voting rights in a manner that gives effect to the provisions of the JV agreement and if necessary alter the Articles of the JV suitably.