

Joint venture / Foreign Collaborations - Certain issues

With the liberalization of Indian Economy, number of Joint ventures and Foreign collaborations were entered into during last fifteen years . Looking at the potential in the India Economy and opportunities available to foreign companies and Investors to join hands with Indians, it would be appropriate to understand the various issues involved in JV/ FC agreements from the point of view of the provisions of the companies Act 1956. This article is an attempt to cover some of the salient aspects of the subject.

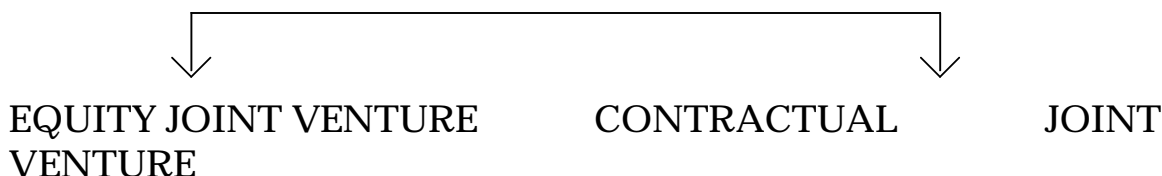
A Joint Venture is an Association of two or more individuals or business entities who combine and pool their respective expertise, resources, skills, experience, credentials and knowledge in the furtherance of a particular project or undertaking.

Joint Venture / Foreign Collaboration agreements commonly referred to as “JVA” or “FCA” are typically signed either by individuals, business entities, corporations or partnerships. The Joint Ventures are either in the form of financial JVs or Technical JVs or a combination of both. In this article for the sake of simplicity the joint Venture and or Foreign Collaboration both have been referred to as JV.

Parties to the JV acquire such rights as may be recognized under the laws of the host country as well as any contractual rights arising out of agreements between the parties. JV Agreements is an agreement in perpetuity. It lasts so long as parties to the JV continue to be in the business.

Terms, conditions, mutual rights, duties / obligations and covenants of the understanding / association are documented in an agreement called Joint Venture Agreement (JVA) or Shareholders' Agreement. Mutual co-operation, trust and confidence between the partners is the foundation of a JV.

MODES OF JOINT VENTURE:



- The Equity Joint Venture is an arrangement whereby a separate legal entity is created in accordance with the agreement of two or more parties.
- The parties undertake to provide money or other resources as their contribution to the assets or other capital of that legal entity.
- The Contractual Joint Venture might be used where the establishment of a separate legal entity is not needed or the creation of such a separate legal entity is not feasible .
- This agreement can be entered into in situations where the project involves a temporary task or a limited activity or is for limited term.

Parties to JV Agreement agree on various terms and conditions such as proportion of capital contribution, management operation, duration and termination.

Where one or more legal methods are used in the establishment of the joint venture company to carry out its operations is based on the negotiations between the parties, the results of which reflect in the joint venture agreement entered into between the parties. The licensing agreement, know how agreement, technical services or technical assistance agreement, royalty payment , franchise agreement and agreement covering all other commercial matters

including use of intellectual property rights normally form annexes or attachments to the main J V Agreement. They can be signed simultaneously or after the joint venture Company is established.

LEGAL FRAMEWORK:

The Companies Act, 1956, (“the 1956 Act”), is an enactment dealing with the limited liability corporations. It provides the basic legal framework for the organisation , management and governance of joint venture companies in India. In most cases, a JV is ‘a closely-held company’. It is in the nature of quasi-partnership.

A JV is, just like any other company, governed by the provisions of the Companies Act 1956 Act, and Memorandum of Association (MA) and Articles of Association (AA). But unlike any other company, the JV is also governed by the JV Agreement (JVA) . A JVA is identical to a partnership deed stipulating rules of management and governance of the JVC and rights, duties, obligations and privileges and mutual covenants of the JV partners.

Broadly, the Companies Act provides a structure that facilitates creation and management of a corporate entity as a limited liability company, which may be either a private limited or a public limited company. Whether to form a public limited company or a private limited depends on the size and nature of a joint venture and the understanding of JV partners .

Memorandum & Articles of Association

The Companies Act requires every company to have a Memorandum of Association and Articles of Association. The Memorandum of Association is the charter of the company. It has six clauses. Name, Address, Objects, Capital , Liability and subscription Clause. The objects specified in it, as required by the 1956 Act, cannot be overstepped. Any ultra-vires activity has serious consequences . The Memorandum of Association is in a way a flexible document and can

be altered by the shareholders in accordance with the provisions of the Act. A contract by a company on a matter not included in the Memorandum of Association is, therefore, ultra vires.

Articles of Association are regulations for internal management of the company. They are the rules or bye-laws for the conduct of Board & Shareholders meetings, issue and transfer of Shares, Powers & duties of Directors , Managing Director etc.

EFFECT OF ARTICLES OF ASSOCIATION:

According to section 36 of the 1956 Act, the Memorandum of Association and the Articles of Association shall bind the company and its members. They bind to the same extent as if, they, respectively had been signed by the company and by each member, and contained covenants on its and his part to observe all the provisions of the Memorandum of Association and of the Articles of Association.

It follows from the principle laid down by the courts in number of cases, and the statutory provisions contained in sections 9 and 31 of the 1956 Act that:

- firstly, anything contained in any document which is inconsistent with the provisions of the Act or the Memorandum of Association or the Articles of Association of the company, is ineffective and cannot be enforced; and
- Secondly, any agreement between shareholders of a company to which the company is not a party is not binding on the company.

MANAGEMENT CONTROL AND ADMINISTRATION:

Composition of the Board of Directors of the Company can be determined by the Joint Venture Agreement and corresponding provisions can be made in the Articles of Association of the Company.

Parties to the Joint Venture can decide on the matters such as total number of Directors, number of Directors to represent parties to the JVA, appointment of Managing Director, Chairman. Accordingly provisions can be made in the Articles of Association of the Company

It is common to provide in the JVA, that every resolution of the Board relating to specified matters shall require affirmative vote of a majority comprising at least one director each representing the partners in the JV.

Following are usually the matters, which are listed for the purpose.

- Employment and removal of CEO and other key personnel, their remuneration
- Borrowing monies by JVC
- Creating security on JVC's property and assets
- Alteration of authorised / subscribed / paid up capital
- Issue of further shares, finding strategic partners
- Payment of final / interim dividend, dividend policy
- Filling of vacancies in the Board, alternate Directors , additional directors
- Contracts with associates and other affiliated or interested parties, relate party transactions
- Acquisition / disposal of fixed assets
- Purchase, sell or leasing of immovable property
- Making or guaranteeing loans by group companies
- Formulating and approving business plans
- Marketing arrangements
- Diversifying business
- Appointment of auditors, legal advisors, etc.

- Acquiring licence or rights from third parties in respect of intellectual property
- Granting sub-licence in respect of intellectual property
- Instituting, abandoning or compromising any legal proceedings
- Formation of subsidiary, investment in other companies, merging with another company, sale of undertaking(s) to any third party
- Shifting the registered office
- Winding up of the JVC
- Calling, convening or adjourning shareholders' meetings
- Approving balance sheet and profit and loss account
- Alteration of M/A and M/A
- Lending money to directors or their relatives
- Appointment & Remuneration of Auditors
- Other policy matters etc.

It is a usual practice that majority shareholder can nominate a director on the Board of company however that director should be left free to exercise his best judgment in the interests of the company which he serves. It is improper, unfair and also illegal to expect such nominee to act only in the interest of the person nominating him. Interest of the JV is prime .

CHAIRMAN'S CASTING VOTE -

Casting vote is a vote given by a chairman to decide an issue when votes on each side are equal. It is a vote of a chairman of a meeting, which he can use in the event of a tie in voting, i.e. equality of votes in favour of and against a resolution. A casting vote is therefore a vote, which is decisive in that it turns or tilts the scales on one side or another. The basic principle underlying the casting vote is that it cannot be used by the chairman unless the votes for and against a resolution proposed at a meeting are equally divided resulting into a deadlock. The chairman may cast his casting vote if he wishes to break the deadlock which would otherwise ensue.

One of the issues that often arise in the negotiations with regard to a JV in India is, concerning casting vote with respect to directors' meetings. This invariably happens when there is 50:50 JV . It sometimes becomes a debatable issue as to whether the JVA and Articles of Association of the proposed JV should contain a provision regarding casting vote. Sometimes the purpose behind the casting vote is overlooked and needless debate takes place.

QUORUM OF BOARD MEETING:

Section 287 of the Companies Act 1956 states that Quorum for the Board Meeting shall be 1/3rd of its total strength or two Directors whichever is higher.

Provision can be made in the Articles of Association of the Company that unless one Representative is present from either of the parties to the JVA a Board Meeting cannot be convened.

FEMA PERSPECTIVE:

India opened up its economy with the pronouncement of a new Industrial Policy on July 24, 1991. Since then there has been a spree of joint ventures. The policy on foreign direct investment has been substantially liberalized. Foreign investment through joint ventures is virtually freely permitted. Foreign equity even up to 100% is allowed in number of sectors.

Total Equity Investment to be made in the Joint Venture Company depends upon the sectoral caps as mentioned in the Foreign Exchange Management Act 1999 and Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000

A proposal for joint venture with foreign equity, does not require any approval if it conforms to the industry / product classification and foreign equity limit. Only those joint venture proposals, which do not

satisfy these two criteria, require the Government of India's, i. e. FIPB's approval

In one of the significant amendment brought in by the notification AP Dir no. 16 issued on 4th October, 2004 FIPB approval has been dispensed with for transfer of shares from Resident to Non-Resident. Further approval of Reserve Bank of India has also been dispensed for transfer of shares from Non-Resident to Resident.

Now the powers have been delegated to the Authorized Dealers. Transfer can be effected by submission of Form FC (TRS).

Further Government has reviewed the guidelines notified vide Press Note 18 (1998 series) which stipulated approval of the Government for new proposals for foreign investment/ technical collaboration where the foreign investor has or had any previous joint venture or technology transfer/ trademark agreement in the same or allied field in India. The need for obtaining NOC from the existing JV partner has been done away with.

Now Prior approval of the Government would be required only in cases where the foreign investor has an existing joint venture or technology transfer/trademark agreement in the 'same' field. The onus to provide requisite justification as also proof to the satisfaction of the Government that the new proposal would or would not in any way jeopardize the interests of the existing joint venture or technology/ trademark partner or other stakeholders would lie equally on the foreign investor/ technology supplier and the Indian partner.

DRAFTING OF JV AGREEMENT:

The Joint Venture is one of the most effective and common mode of conducting the business internationally. The drafting of Joint Venture Agreement and other documents is critical to the success of the venture. The Joint Venture Agreement forms the basis of the understanding between and among the parties.

The importance of the documents and the purpose of this part is to cover, step by step, the critical elements to consider and include in the joint venture agreements. Following are some of the standard clauses that are included in the Joint Venture Agreement:

- Organisation and incorporation of a Joint Venture Company (JVC)
- Corporate name and registered office of JVC
- Objects of the JVC
- Share capital, classes of shares, alteration of capital, voting rights, dividend policy
- Contribution by the partners in the JVC's equity
- Marketing and distribution arrangement, including exports
- Transfer of shares
- Board of Directors, powers of the Board and management of the JVC
- Maintenance of books of accounts, appointment of auditors and legal advisors
- Dividend policy
- Use of trademark on products to be sold in and outside India
- Term and termination of the Agreement, including deadlock situation
- Non-competition by the partners
- Representations, covenants and warranties
- Confidentiality and exclusivity
- Non-assignment
- Mechanism for dispute resolution, including conciliation and arbitration.
- Technical Assistance and Licence Agreement
- Memorandum and Articles of Association

It is common to enter into a separate agreement between the JVC and the foreign partner for supply of technology to the JVC for which the foreign partner is compensated by technical fee and / or royalty. This is governed by a separate agreement called Technical Collaboration and Licence Agreement.

Apart from the Joint Venture and Technical Collaboration Agreement depending upon the circumstances following agreements can be entered:

- Agreement of Confidentiality
- Corporate Name User and Protection Agreement
- Trademark Licence Agreement
- Asset Sale Agreement
- Distribution Agreement
- Supply Agreement
- Management Services Agreement

It is desirable that to avoid any controversies in future all the salient terms of JV & other agreements are made part of the Articles of Association.

To conclude I may say that in order to create a win - win situation for both, Indian entrepreneurs and also Foreign Investors, JV is a good tool to venture into a business opportunity. Needless to say that a lot depends on the mutual trust and confidence. Complying with the appropriate procedures and avoiding communication gaps are quite vital to the success of any JV.

Careful drafting of JV agreement is a key to the success of JV.