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International technology joint ventures: a UK perspective

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Selecting the Form of the Joint Venture

In selecting the form of the joint venture, there are three different structures available:

(1) *The Co-operation Agreement.* This is an agreement between the parties who wish to co-operate which does not involve setting-up an independent vehicle to carry out the co-operation.

(2) *The Corporate Partnership.* A partnership between two or more companies which is used as the vehicle through which the co-operation is carried out. In practice the corporate partners will nearly always be subsidiaries of the parties wishing to co-operate.

(3) *The Joint Venture Company.* A company in which the parties wishing to co-operate both take a shareholding. The company is then used to carry out the co-operation.

One obvious advantage of the joint venture company and the corporate partnership is that they can more readily separate the activities of the co-operation from the other activities of the parties concerned.

The Differences Between the Structures

Liability

Liability to third parties in a co-operation agreement is not limited except to the extent that either the parties are themselves limited liability companies or the co-operation agreement provides for any right of contribution or indemnity. In order to ensure that co-operation agreements do not unintentionally constitute either a partnership or an agency, care needs to be taken in the drafting of the agreement. An express clause stating that neither a partnership, nor an agency is formed by the agreement may help avoid such a relationship being deemed to exist, although it is still not conclusive.

The normal rules of partnership liability apply to corporate partners and their liability is therefore joint and several and extends beyond the capital invested in the partnership business by the partners. However, by having limited companies as the partners the maximum liability of the parties to the co-operation is confined to the assets of the partners, subject only to lifting the veil (see below).

The liability of the partners in the corporate partnership will be joint and several and accordingly third parties will be able to proceed against any one or more of the partners without first going against the partnership assets themselves. For this reason it is usual to insist upon 'clean' companies which have never traded and to obtain warranties to this effect from the parties to the venture. Where it is necessary to use a company that has traded, more comprehensive warranties are required. If this is not done and the only asset of the company is its interest in the partnership, liabilities arising prior to the formation of the partnership could materialise and the other partner could find itself in partnership with an insolvent company. Even though it would not itself have any exposure in respect of such liabilities of its partner the situation would leave much to be desired and losses could arise from, for example, the early termination of the partnership.

Because the liability of the partners is joint and several it is normal for the parties to have cross guarantees from the parent companies giving an indemnity where liability arises through the default of their respective subsidiaries.

One of the principal reasons for using a joint venture company is to limit the liability that can arise from the co-operation. By using a limited company as the vehicle for the joint venture the maximum liability of the parties will be the assets of the joint venture company. The liability will only extend beyond this in the cases where the 'corporate veil' is lifted. Examples of this include: (i) CA 1985 s24 -- number of members of a company falling below the required level; (ii) CA 1985 s630 -- fraudulent trading; (iii) under case law -- where there has been fraud or improper conduct, eg *Gilford Motor Co* v *Horne* [1933] Ch 935.

The limitation of liability afforded by using a limited company is often diluted in practice by the fact that it may be necessary for guarantees to be given by the shareholders to third parties in respect of certain activities of the venture, for example, to secure bank overdraft facilities. Furthermore it is not unusual for one of the parties to insist upon a clause to the effect that the parties will keep the joint venture company or each of the corporate partners funded to the extent necessary to ensure solvency. Such a clause may be absolute or subject to limited exceptions to cover extraordinary circumstances. One reason for requiring a clause of this nature is that the insolvency of a subsidiary may trigger a default clause in group funding documents such as loan stock trust deeds.

Most forms of co-operation, whatever the structure, will provide for the parties to maintain adequate insurance to cover normal commercial risks.

Taxation

Tax considerations, whilst outside the scope of this article, will be a major factor in deciding which is the most beneficial structure. Two points are, however, worth noting. The first is that a joint venture company can be structured in such a way as to be a subsidiary of one company for the purposes of group income and group relief (Taxes Act 1970 s256 and 258) and yet a subsidiary of another company for company law purposes (CA 1985 s736). The second is that due to the changes in group relief in the 1985 Finance Act, a joint venture company no longer suffers the disadvantages it previously had compared to a corporate partnership in relation to the transfer of losses throughout a group.

Formalities and management structures

The co-operation agreement allows for a flexible management structure in much the same way as the corporate partnership which is far more flexible than that of a company. There is no pre-existing structure such as Table A and it is therefore necessary to agree and set out the management structure and formalities to be used. This enables the formalities to be readily tailored to meet individual requirements.

A common form of management structure for the corporate partnership is by committee. Although the accounts of a partnership do not have to be filed, third parties are able to inspect the accounts of each of the corporate partners which have to be filed in the normal way at the companies registry.

The joint venture company will be subject to all the provisions of the Companies Acts and will accordingly have to adopt the management structure and comply with the formalities this automatically entails. This is not necessarily a major disadvantage especially as management structures can be used below the level of director.

The business of the company will be restricted to the areas permitted by the memorandum of association although of course this can be altered if necessary. However, any activity of the joint venture company which goes beyond the power set out in its memorandum will be *ultra vires.* The effect of the ultra vires doctrine has been reduced by the European Communities Act 1972 s9(2) in the case where a third party is dealing with a director of the company. However any *ultra vires* transaction can: (i) be repudiated by a third party; (ii) be restrained by injunction by the members of the company; or (iii) entitle the members of the company to recover any losses arising from the *ultra vires* transaction from the officers involved.

Deadlock

Deadlock may arise either when no party to a venture has control and the parties are unable to agree on the course of action to be taken or in some cases where even though one party has a controlling interest the minority interest has a veto on certain fundamental areas, such as where major capital expenditure is required. Deadlock can arise under all three structures.

It is possible for a number of different remedies to be provided for when deadlock arises, for example, one of the parties to be given a casting vote. From a technical point of view this is the remedy to be preferred although unfortunately, it seldom seems to be commercially acceptable.

Alternatively, arbitration can be used. This has the advantage of being confidential, but where deadlock arises from disagreement on a commercial point it is not entirely satisfactory to have a third party make the decision. For this reason it may be beneficial, especially where larger companies are involved, to include a provision stating that any matter will be referred to the chairmen to see if they are able to resolve the matter before arbitration or termination takes place.

Group accounts

Where a joint venture company is a subsidiary within the meaning of CA 1985 s736, accounts will have to be consolidated with those of its parent company. The profits and losses for the whole company will therefore appear 'above the line' and be subject to adjustment below the line to take account of any minority interests. Such a subsidiary should, however, be excluded from consolidation if:[1] (i) its activities are so dissimilar from those of other companies within the group that consolidated financial statements would be misleading; or (ii) the holding company does not own share capital carrying more than half the votes or has contractual or other restrictions imposed on its ability to appoint the majority of the board of directors of the joint venture company; or (iii) the subsidiary operates under severe restrictions which significantly impair control by the holding company; or (iv) control is intended to be temporary.

The Transfer and Protection of Technology

The transfer of technology

Where a joint venture company is used the parties may be willing to assign technology rights to the company absolutely. However, an assignment can mean that the assignor loses control of the technology (and the right to use it independently unless there is some form of licence granted back). This approach is not usual except perhaps where the assignor has a controlling interest in the joint venture company.

The more usual method of transferring technology into a joint venture is by means of a licence. The nature of the licence, including such things as whether it is to be exclusive, sole or non-exclusive will depend upon a number of factors including: (i) the scope of the joint venture; (ii) the rights of the parties licensing the technology (ie the extent of their ability to grant licences); (iii) whether the technology is used by the licensor independently of the joint venture either in the same or different fields; and (iv) the duration of the joint venture.

Common restrictions contained in technology licences include field of use restrictions, time limits and prohibitions on disclosure. Depending upon the input of the parties to the joint venture the technology licence may or may not include a provision for the payment of royalties to the licensor.

The continuation of any licence, or perhaps the exclusivity under the licence, may depend upon the performance of the joint venture so that if certain levels of production or sales are not achieved the licence will terminate (or become non-exclusive). However, as in many cases the technology will be central to the joint venture it will often be preferable to provide for the joint venture to terminate if it does not perform adequately rather than to provide only for the termination of the technology licence (which could have the same result).

It is essential for any joint venture agreement to set out exactly what is to happen to its technology rights on the termination of the joint venture. There are likely to be at least three sources of technology held by the joint venture: (i) technology that has been licensed or assigned to the joint venture; (ii) technology developed directly from licensed technology; and (iii) technology developed independently of any licensed technology. Provisions should be made for each of these and in determining the nature of the provisions consideration needs to be given as to whether the parties to the joint venture would wish to compete directly on termination or whether some form of option to buy out is to be preferred.

The protection of technology

Both the joint venture agreement itself and any ancillary agreements dealing with the transfer of technology to or from third parties will need confidentiality provisions. Such provisions will provide that subject to certain standard exceptions the technology will not be disclosed to any third parties other than those specified in the agreement. These may include: manufacturers, suppliers and contractors; agents and sub-licensees (both actual and potential); governmental and other authorities or regulatory bodies; and employees of the above.

Even where disclosure is permitted it should only be to the extent that it is necessary for the performance of the contract. Further, it should be subject to the disclosing party obtaining (and agreeing to enforce) from the party to whom the technology is to be disclosed, a confidentiality agreement. The form of such a confidentiality agreement can either be set out in a schedule or left to be agreed.

The joint venture may also be able to protect technology and other intellectual property through the use of intellectual property rights. The agreement should provide a procedure for agreeing the registration of patents and trademarks etc. Such provisions should set out the rights of the parties if they cannot agree whether or not to register. Similar provisions will also be required to cover the enforcement of intellectual property rights.

Competition Law

When entering into any joint venture agreement it is essential to consider the possible competition law ramifications as all joint ventures can be regarded as inherently anti-competitive. This is because any joint venture entails two (or more) parties joining forces to do that which (at least arguably) they could each individually be doing. However, it has been increasingly recognised, particularly by the European Commission, that joint ventures can be beneficial to and stimulate competition.

The Restrictive Trade Practice Act 1976 ('RTPA')

For the RTPA to apply there are three pre-conditions which must be satisfied:

(1) There must be an agreement or arrangement (which need not be formal or in writing).

(2) The agreement must be between two or more persons carrying on business in the UK in the production or supply of goods (s6) or services (s12).

(3) Restrictions must be accepted by two or more of the parties to the agreement.

In the field of international joint ventures, the second of these pre-conditions can often limit the impact of the RTPA as it may be possible to structure the joint venture so as to ensure that only one party carries on business in the UK. It should be noted that: (i) two or more interconnected corporate bodies count as only one person for calculating the number of parties to an agreement (s43(2)). Accordingly a joint venture company can be structured so that it is a s736 subsidiary of one of the shareholders whilst control is in fact shared or in the hands of another of the shareholders. This is done by giving more than half in nominal value of the equity share capital to one shareholder but attaching different voting rights to different classes of shares; (ii) in a corporate partnership each corporate partner is counted as a person for calculating the number of parties to the agreement; (iii) a person is not deemed to carry on business in the UK by reason only of the fact that he is represented for the purpose of that business by an agent in the UK (s43(4)).

For the purpose of determining whether there is an agreement or arrangement, connected agreements may be counted as a single agreement. Further, the agreement does not need to be enforceable in law (s43(1)).

For a restriction to be relevant it has to come within the terms of the RTPA. In the case of agreements relating to goods, the restrictions must relate to one of the matters referred to in s6 and, in the case of services, one of the matters referred to in s12. The RTPA gives the word 'restriction' a wide meaning and care should, therefore, be taken when considering the applicability of the act.

EEC competition law

Article 85(1) of the Treaty of Rome prohibits as incompatible with the common market all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between member states and which have as their object or effect the prevention, restriction or distortion of competition within the common market.

Article 85(2) provides that any agreement prohibited by art 85(1) shall be automatically void. Article 85(3) provides that the provisions of art 85(1) may be declared inapplicable in individual circumstances if the necessary criteria are fulfilled.

New guidelines which the Commission would follow when considering joint ventures have been outlined in a draft policy notice on joint ventures issued by the Commission in December 1985. The notice makes it clear that the Commission regards joint ventures that affect only one Member State or countries outside the EEC to be not subject to art 85(1) as they are not likely to affect trade between Member States. Furthermore, joint ventures whose effects on trade between Member States and on competition are negligible and which therefore do not have an appreciable effect on market conditions are also not subject to art 85. In its 1977 notice on agreements of minor importance the Commission stated that an agreement would not be regarded as having an appreciable effect where the combined market share of the parties is not more than 5 per cent and their aggregate turnover is not more than 50 million ECU. The guidelines would effectively remove the turnover qualification in relation to joint ventures.

In relation to art 85(3) the draft policy notice states:

'if the partners' combined market share does not exceed 15 per cent, it can normally be assumed that the joint venture does not distort the competitive structure of the market. This is also true of joint ventures which include distribution, although the closer the partners' market share is to the threshold, the more detailed becomes the necessary analysis.'

The 15 per cent market share criterion set out in the statement would, whilst not removing the need to notify agreements, be sufficient to take the majority of joint ventures outside art 85.

The recent block exemptions covering research and development agreements and specialisation agreements will be of benefit to some joint ventures but because of the detailed criteria that need to be satisfied (for which see the block exemptions themselves) they will not be of general application.

If a joint venture agreement does not come within the terms of one of the block exemptions then it will be necessary to seek clearance under art 85(3). In order to obtain such clearance it is necessary to show that the agreement contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit and that it does not: (i) impose on the undertakings concerned, restrictions which are not indispensable to the attainment of those objectives; or (ii) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products.

The new guidelines on joint ventures issued by the Commission set out some of the assumptions on which the Commission would generally operate when considering individual exemptions. In addition to the 15 per cent market share criterion already referred to, the draft guidelines state that the Commission will continue to proceed on the basis that joint ventures normally contribute substantially to improving the production and distribution of goods, promote technical and economic progress and serve the interests of consumers. This will in particular be so where the joint venture, by means of rationalisation, introduction of new or improved products or processes or the opening of new markets, serves as 'an instrument of innovative competition in a structurally competitive market'. The Commission will also take a favourable view of joint ventures involving major new investment. The draft guidelines are in the course of being revised, and a new draft is expected later in 1986.

Mergers legislation

In the case of joint ventures between parties having large shares of the relevant market, the mergers legislation contained in the Fair Trading Act 1973 should be noted. A merger situation will arise where two or more enterprises cease to be distinct and as a result of the merger the new entity will have at least 25 per cent of the relevant market.

The Competition Act

The Competition Act may be applicable to any joint venture if the co-operation involved amounts to an anti-competitive practice by one or more of the parties, that is, a practice which has or is intended to have or is likely to have the effect of restricting, distorting or preventing competition within the UK. It should be noted however that the Competition Act will not apply unless one of the persons involved has more than one quarter of the relevant market. Furthermore the Competition Act is not applicable to any agreement which is caught by the provisions of the Restrictive Trade Practices Act.

Comp. Law. 1986, 7(3), 91-94

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1. Companies Act 1985 s229 as interpreted by the Statement of Standard Accounting Practice on Group Accounts (No14 1978).