A perspective on joint venture: an international business expansion strategy and legal implications with specific reference to India

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Abstract

Collaboration between firms is not a new concept, but the new thing that can be seen is that the collaborations have increased significantly during the past couple of decades, along with the increasing international competition. Moreover, the nature of collaboration has changed, shifting from peripheral interests to the very core functions of the corporation, and from equity to non-equity forms of collaboration. This paper essentially focuses on the legal framework governing the various aspects of a Joint Venture in India in brief, the methods of Joint Ventures, as well as RBI regulations on the topic. The research methodology adopted is largely analytical and descriptive. Reliance has been placed largely on various sources like articles and online articles.

Keywords: *joint venture, business strategies, expansion of business, types of joint ventures, Indian legal framework, RBI guidelines, arbitration clause, Supreme Court judgments.*

JEL Classification: K22, K33, K41

1. Introduction

India's economic growth is attracting business houses from across the world. The mechanism today, to form combination through mergers or amalgamation or acquisition is well known but another special vehicle, known as Joint Venture has become a preferred form of corporate entities to form combination and go for investment in India. Joint Venture is a popular method to enter a country whose legal and business environment is unknown. In recent years, India has made it easier for foreign investors to enter its markets. However, foreign investors may want to set up a joint venture with an Indian partner rather than enter India's markets alone since the joint venture route can be beneficial for all the parties involved if done properly, with the right planning. Foreign companies need to be aware of the corporate structures that they can choose when working in India. Sometimes a contractual joint venture is a better option than an equity-based joint venture. The choice of model of joint venture is, of course, determined by the objectives that the partners have and also whether they intend their relationship to be long term or short term.

There are no separate laws for joint ventures in India and are governed by contractual relationship as well as corporate legal entity relationship as in case of Incorporated Joint Venture. The Joint Venture formed due to contractual relationship

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having no separate entity leads to Unincorporated Joint Venture while if it is formed under the company law then it would qualify as Incorporated Joint Venture.

2. Methods of joint venture

The two options available for establishing a joint venture in India are:
1. Contractual joint venture
2. Equity based joint venture

2.1 Contractual joint venture

In a contractual joint venture, a new jointly owned entity is not created. There is an agreement to work together but there is no agreement to give birth to an entity owned by the parties who are working together. The two parties do not share ownership of the business entity but each of the two parties exercises some elements of control in the joint venture.

The following are some of the features of a contractual joint venture:

a) Two or more parties have a common intention – of running a business venture
b) Each party brings some inputs
c) Both parties exercise some controls on the business venture
d) The relationship is not a transaction to transaction relationship but has a character of relatively longer duration.

Foreign companies often resort to contractual joint ventures when they do not wish to invest in the equity capital of a business in India even though they wish to exercise controls and want to decide the shape that the venture takes.

2.2 Equity Based Joint Venture (EJV)

In an equity joint venture agreement, a separate business entity, jointly owned by two or more parties, is formed in accordance with the agreement of the parties. The key operative factor in such case is joint ownership by two or more parties.

The form of business entity may vary – company, partnership firm, trusts, limited liability partnership firms etc. From the point of a foreign company, the most preferable form of business entity is either a company or a limited liability partnership firm.

Some of the features of an equity based joint venture are as follows:

a) There is an agreement to either create a new entity or for one of the parties to join into ownership of an existing entity
b) Shared Ownership by the parties involved
c) Shared management of the jointly owned entity
d) Shared responsibilities regarding capital investment and other financing arrangements.

e) Shared profits and losses according to the Agreement.

Following are some of the types of Equity based Joint Ventures:

Company: A limited liability company is the most preferred structure for joint venture entities in India. Government also encourages investment being in the form of equity capital of a company incorporated in India. Companies in India are mainly of two types: private limited and public limited. After the coming into force of Companies Amendment Act, 2015 there is no minimum share capital prescribed either for private limited company or public limited company unlike before, where the minimum prescribed share capital for a private limited company used to be Rs. 100,000- and for a public limited company it used to be Rs. 500,000. A private limited company must have at least two shareholders, while a public limited company must have seven shareholders. However, a one-person company is an exception to this. The shareholders may be foreign citizens or foreign companies. Companies Act 2013 makes it mandatory that at least one director of every company is resident of India.

The Companies Act 2013 governs a Joint Venture in a form of a company. Even though the formation and incorporation of the company involves the drafting of a multitude of documents like the MoA, AoA, but at the same time it is the most preferred type of Joint Venture since it allows the parties to make a tailor made agreement as per their requirements. There is only one condition which should be kept in mind i.e. the Joint Venture Agreement will not be binding on the JV company if the terms and conditions of the JVA are not included in the latter, as held in *VB Rangaraj v. VB Gopalkrishnan and Ors* [2] by the Supreme Court.

Partnership Firm: In most of the cases, such an entity is not permitted for joint ventures by foreign residents in India. Exceptions are made in case of Non Resident Indians or Persons of Indian Origin residing out of India. However, such exceptions are subject to various conditions.

Limited Liability Partnership (LLP) Firm: LLP Firm structure is regulated in India by The Limited Liability Partnership Act, 2008. Foreign investment in LLP Firms was not permitted before November 2015. Government of India has now allowed foreign investments in LLP firms subject to certain restrictions. LLP Firms are partnership firms with limited liability of partners. An LLP Firm combines the convenience of a partnership firm with the limited liability feature earlier found only in a company. An LLP Firm needs minimum two partners. It Joint Ventures in India also requires minimum two Designated Partners out of which at least one should be resident of India. The two partners can also be appointed as Designated Partners. There is no requirement of minimum capital contribution to incorporate an LLP Firm.

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[2] AIR 1992 SC 453.

3. Laws governing joint venture in India

A joint venture involves two business entities or individuals with aligned strategic interests entering a legal arrangement where each party will contribute resources to accomplish a common goal. This entry explores several legal issues to consider when planning a joint venture. Hence, it becomes important follow the laws and rules governing the matters related to Joint Ventures. Though, there is no separate law for incorporation or registration of Joint Venture in India; it is incorporated or established like a private company or public company under the Indian Companies Act, 1956. There are some other Indian laws which are applicable on JV:

- Companies Act, 2013
- Competition Act, 2002
- Partnership Act
- Foreign Trade (Development and Regulation) Act, 1992
- Industrial Policy and Procedure
- Policy for Foreign Investment
- Contract Act
- Foreign Exchange Management Act, 1999
- SEBI Guidelines, Regulations, Notifications & Circulars

An unincorporated joint venture is a contractual joint venture that is affected by a legally binding agreement, and does not involve the incorporation process. It does not create a separate corporate entity or create equity capital. Thus, it is very much like a partnership. This kind of joint venture is generally entered into for a limited period or for a particular purpose and does not join the parties for perpetuity. An unincorporated joint venture may be either by way of contract or partnership. A joint venture formed by way of partnership is governed by the Indian Partnership Act, 1932.

An incorporated joint venture is one that uses a company established for the purpose of the joint venture, with the ventures acquiring shares in the company. It is either a public or a private company with limited liability in which the shareholders are the joint venture participants. Here, the shareholders have no rights in relation to the company's assets. They can participate in the profits (which are distributed as dividends), but not in the losses. Basically, in this kind of joint venture, the equity of the project is divided into shareholdings. All incorporated joint ventures in India are domestic companies, and are governed by the provisions of the Companies Act, 1956.

Joint Ventures and Wholly Owned Subsidiary have been defined in the Foreign Exchange Management (Transfer and Issue of Foreign Security) Regulations, 2000 as: Joint Ventures means a foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country in which the Indian party makes a direct Investment.

Formalities to be decided and fulfilled:

a) whether the joint venture company will be a public or a private limited company,
b) the place of Registered Office of the Joint venture Company,
c) propose a name of the joint venture company and check its availability from the Registrar of Companies (ROC) where the registered office of the company is to be situated and the company is to be incorporated,
d) choose the subscribers to the Memorandum of Association which will obviously include the partners to the joint venture and their nominees,
e) prepare the Memorandum and Articles of Association in consultation with the joint venture partners , get them printed and suitably stamped, and submitting the same with required documents like statutory declaration u/s 33 of the Companies Act 1956 (Act) and Form no.18 u/s 146 of the Act regarding address of the registered office, to ROC along with fees payable.
f) On receipt of certificate of incorporation, the new company may start business,
   i. in case of private company, immediately.
   ii. in case of public company, after obtaining certificate of Commencement of Business for which the company has to file with the ROC prospectus/statement in lieu of prospectus, and the statutory declaration u/s 149 of the Companies Act 1956, duly stamped.
g) Articles: To avoid contradictions, the Articles of Association should contain the stipulations mentioned in the joint venture agreement and clearly delineate the rights and obligations of the partners.

Reserve Bank of India (RBI) regulations related to Joint Venture: Direct investments by residents in Joint Venture (JV) and Wholly Owned Subsidiary (WOS) abroad are being allowed, in terms of clause (a) of sub-section (3) of section 6 of the Foreign Exchange Management Act, 1999, (42 of 1999) read with Notification No. FEMA.120/RB-2004 dated July 7, 2004, (GSR 757 (E) dated November 19, 2004), viz. Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004. These Regulations are amended from time to time to incorporate the changes in the regulatory framework and published through amendment notifications.

Within the contours of the Regulations, Reserve Bank of India also issues directions to Authorised Persons under Section 11 of the Foreign Exchange Management Act (FEMA), 1999. These directions lay down the modalities as to how the foreign exchange business has to be conducted by the Authorised Persons with their customers/ constituents with a view to implementing the regulations framed.

Prior Approval of RBI in cases of Opening of branch/subsidiary/joint venture/representative office or undertaking investment abroad by Non Banking Financial Companies (NBFC): No NBFC shall open subsidiaries/joint ventures/representative office abroad or shall make investment in any foreign entities without obtaining prior approval in writing from the Reserve Bank of India. The application from the NBFC seeking No Objection would be considered subject to these directions. These directions are in addition to those prescribed by Foreign

Exchange Department for opening of branches abroad or for investments in Joint Venture/Wholly Owned Subsidiary.

Non resident partner. In case one of the partners of the joint venture company is a non resident, approval of Reserve bank of India will be required for acquiring shares of the company and establishing place of business in India u/s 19 and 29 of Foreign Exchange Regulation Act 1973 (FERA). However RBI has granted general permission vide its notification dated 26-4-1993, as amended, u/s 19(1)(d) and u/s 29(1)(b) of FERA to a non resident Indian citizen / person of Indian origin to subscribe to the memorandum and articles of association of a company for the purpose of incorporation in India. And such company is also permitted to issue shares to the non residents subject to the condition that the total face value of shares is not to exceed Rs 10,000/-, the company will not engage in the activity of agriculture / plantation/dealing in real estate other than its development and the company files a declaration with RBI within 90 days of its incorporation.

Inter-corporate investment u/s 372A of Companies Act. When an Indian company [partner] acquires shares of the joint venture company which is exceeding 60% of its [Indian company's] paid-up capital and free reserves or 100% of its free reserves, whichever is more, Section 372A will apply requiring prior Board decision of the Indian company as well as special resolution of its shareholders. If a foreign company acquires the shares, this section will not be invoked as it applies only to a "company" defined under section 3 (1)(i) of the Act which does not take into account a foreign company.

The Joint Venture agreement should be conditional upon obtaining all necessary approvals/ consents/ licenses /permissions of appropriate agencies of Government of India like RBI/SIA etc within specified period. If any of the approvals are not received, or received late, the agreement cannot be enforced and the joint venture cannot proceed on the basis of the Agreement.

Important Clauses. Selection of good local partner is the key to the success of any joint venture. A joint venture agreement requires dexterous legal drafting and should incorporate clearly the relevant clause that specifies the mutual understanding arrived at between both parties as to the formation, registration and operation of the joint venture company. A brief checklist of important clauses: Name of the parties of Joint venture - Place of execution of agreement - The proportion of shareholding pattern in the Joint Venture - Specify nature of shares - Composition of Board of Directors, appointment and changes in chairman, Quorum of meeting, casting vote provision in Board Meeting - Appointment of CEO/CFO - General Meeting provision - Appointment of Management Committee - Dividend Policy - Funding Provision - Access Condition - Change of Control/Exit Clause - Anti Compete Clause - Maintaining Confidentiality - Indemnity Clause - Applicable Law - Force Majeure - Termination of Agreement.

4. Arbitration clause

Opting for litigation as the mode of dispute resolution, even if foreign law is chosen as the governing law, is not advisable. Orders passed in most jurisdictions are not recognized in India. Arbitration would be a preferred mode of dispute settlement especially since foreign arbitral awards are recognized and enforced in

India. The Dispute Resolution Mechanism under the Indian Judicial Mechanism consists of: Resolution of disputes through court and statutory tribunals; resolutions of disputes through mechanism of conciliation or arbitration as alternatives to Court and Tribunals. The framework of arbitration in India is based on maximum party autonomy with minimum judicial intervention and also recognized as expeditious as well cost effective method for dispute resolution. A large number of commercial contracts in India contain an arbitration clause as a part of the parties' agreement to resolve their disputes though arbitration rather than to Courts.

Scope of the arbitration agreement: this is an important issue in many arbitrations, as this will often determine whether the arbitrators have jurisdiction over the dispute. In some circumstances specific to joint venture disputes the scope of the arbitration clause may be extended *ratione materiae* (i.e. in terms of disputes covered) or *ratione personae* (i.e. in terms of parties involved).

5. Cases

1. The Supreme Court, in *New Horizons Limited v. Union of India and Ors*[3] speaks about Joint Venture as a partnership through which two or more firms create a separate entity to carry out a productive economic activity in which each partner takes active role in decision making. Each party operating a Joint Venture makes substantial contribution in form of capital, technology, marketing experience, personnel or physical assets. Thus Joint Venture is a symbiotic business alliance between two or more companies whereby the complimentary resources of the partners are mutually shared and put to use.

"Joint venture," a term used interchangeably and synonymous with 'joint adventure', or coventure, has been defined as a special combination of two or more persons wherein some specific venture for profit is jointly sought without any actual partnership or corporate designation, or as an association of two or more persons to carry out a single business enterprise for profit or a special combination of persons undertaking jointly some specific adventure for profit, for which purpose they combine their property, money, effects, skill, and knowledge........ Among the acts or conduct which are indicative of a joint venture, no single one of which is controlling in determining whether a joint venture exists, are: (1) joint ownership and control of property; (2) sharing of expenses, profits and losses, and having and exercising some voice in determining division of net earnings; (3) community of control over, and active participation in, management and direction of business enterprise; (4) intention of parties, express or implied; and (5) fixing of salaries by joint agreement."

2. The Hon'ble Supreme Court of India, in *Faqir Chand Gulati v. Uppal Agencies Pvt. Ltd. and Anr*[4] held that "joint venture" connotes a legal entity in the nature of a partnership engaged in the joint undertaking of a particular transaction for mutual profit or an association of persons or companies jointly undertaking some commercial enterprise wherein all contribute assets and share risks.

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[3] (1995) 1 SCC 478.

[4] (2008) 10 SCC 345.

3. Gujarat High Court in *Asia Foundations & Constructions Ltd. v. State of Gujarat*[5]: The Court in its power of judicial interpretation differentiated between a partnership and a Joint Venture. It said, the Courts do not treat a joint venture as identical with a partnership though it is so similar in nature, and in the contractual relationship created by such ventures that the rights as between them are governed practically by the same rules that govern the partnership. This relationship has been defined to be a special combination of persons undertaking jointly some specific venture for profit without any actual partnership. Generally speaking, the distinction between a joint venture and a partnership is that former relates to a single transaction 'though it may comprehend a business to be to be continued over several years' while the later relates to a joint business of a particular kind.

4. The Supreme Court, in another major judgment in the case of *Vodafone International Holding (VIH) v. Union of India (UOI)*[6] cleared the uncertainty with respect to imposition of taxes. The apex court through this judgment recognized:

The principles of tax planning:

- Business entities or individual may arrange the affairs of their business so as to reduce their tax liability in absence of any statutory stipulation prohibiting the same.
- The multinational companies often establish corporate structures and all these structures should be established for business and commercial purposes only.
- The corporate veil may be lifted in case facts and circumstances reveal that the transaction or corporate structure is sham and intended to evade taxes.
- The transactions should be looked holistic manner and not in a dissecting manner and the presence of corporate structures in tax neutral/investor friendly nations should not lead to the conclusion that these are meant to avoid taxes.

It can be said that this judgment has helped in removing uncertainties with respect to imposition of taxes and recognized the principle the if motive of the transaction is to avoid tax does not necessarily lead to assumption of evasion of taxes and the supreme court has endorsed the view of legitimate tax planning.

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[5] AIR 1986 Guj 185.

[6] (2012) 6 SCC 613.