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Corporate Divorce--Japanese Style

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COMMENT

Corporate Divorce – Japanese Style

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THE PROSPECT of corporate divorce in a joint venture in Japan raises special problems for the foreign investor, which are unique to Japan. In other areas of the world, when things went sour with a joint venture, the U.S. partner could just move in and buy out his partner. This alternative has not been available in Japan because of governmental restrictions on foreign ownership,[1] although these restrictions have been recently somewhat liberalized.[2] In addition, American businesses have found it difficult to operate wholly owned subsidiaries in Japan because of cultural and language differences and because of differences in Japanese business traditions and practices. Furthermore, if an American partner in a joint venture were to attempt to force out his Japanese partner, the American company would probably find that the collective attitude of the Japanese business community toward him would be quite cold, rigid, and unified. In

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* The views expressed herein are those of the writer and not necessarily those of TRW Inc., with which he is associated.

[1] The Foreign Investment Law (*Gaishi ni kansuru hōritsu kankeishōrei*) (Law No. 163, 1950) applies to any degree of investment, not merely majority shareholding, but in the past the foreign investor was largely relegated to a minority position. D. HENDERSON, FOREIGN ENTERPRISE IN JAPAN (1973) is probably the best general study of foreign investment in Japan, particularly as to historical aspects.

[2] Cabinet Resolution, Concerning Liberalization of Direct Incoming Investment, April 27, 1973. Note that no significant amendment to the Foreign Investment Law was needed to carry out the liberalization program because of the vast discretion vested by that law in the Cabinet, the Foreign Investment Council, and the government ministries. *See, generally*, F. L. Hartman, "Japanese Foreign Investment Regulation: Semantics and Reality," 18 N.Y. LAW FORUM 355 (1972). Even under the Fifth Liberalization, a number of industries are still subject to restrictions on foreign ownership. *See*, Note, *The Fifth Liberalization of Capital Movements into Japan infra* at 279.

this ostracized position, it would be exceedingly difficult for the American company to attract an alternative Japanese partner.

In addition, after a joint venture in Japan has been terminated, the American company may find itself in competition with its former Japanese partner. Since many Japanese firms enter into joint ventures with the gaining of access to technology as their primary goal, when the joint venture terminates, it may be difficult, if not impossible, to avoid use of this technology, especially where it is unpatented, by the Japanese partner. Suffice it to say, it just does not seem practical for you to assume that your technology can just be gathered up and returned to you when the joint venture is terminated.

It is common for a Japanese firm to be engaged in several joint ventures. *Your* joint venture may be just one of many, in which case your Japanese partner may be able to favor his other joint ventures, especially where they are prospering, and ignore or neglect your interests when insurmountable differences arise.

It is vital that you spell out in detail, in the joint venture agreement, the circumstances that will trigger termination. Normally, the licensing agreement should terminate at the same time; if the licensing agreement is not to terminate, the conditions of its extension should be specified. The agreement must also provide for strict limits on the use of the technology during the life of the joint venture. For instance, it might be best to bind your partner directly to secrecy at all times regarding the know-how transmitted and to commit him not to use that know-how without your prior approval. This committment should survive the joint venture agreement.

If it is deemed desirable that, in the event of termination, the joint enterprise is to continue without the American partner's further involvement, the agreement should provide for the mandatory purchase by the Japanese partner of the American party's interest, at a predetermined price, or at a price determined by an agreed-upon formula. Disposition of the equipment used by the joint venture should also be specified in the agreement. In fact, you should get all understandings in writing, signed by all the parties. Do not rely on verbal understandings, as is done in many European countries, where lawyers oftentimes are not even present at negotiations.

There are no special United States tax problems incident to a joint venture termination other than the capital gain or loss realized at the termination. Where the joint venture has been operating at a loss, it is possible that on dissolution the U.S. partner will realize an overall gain, due to the unrealized value of the venture's assets (in turn due to the enhanced value of the yen vis-à-vis the dollar),[3] and thus, the dissolution may not involve a non-recurring loss on the U.S. company's financial statement.

Some problems may arise from the Japanese tax laws. In addition, problems may arise from the matter of Japanese government clearances[4] on the termination, and from the currency clearances incident to returning funds to the United States.[5] As a general matter, you will find that the transfer of buy-out funds requires Japanese government approval; you will also find that the Japanese investment validation regulations require a mandatory report on the termination of a licensing agreement between a foreign licensor and a Japanese licensee.[6]

It should be stipulated in the joint venture agreement that disputes are to be settled by arbitration pursuant to the Japanese-American Arbitration Agreement of September 16, 1952.[7] This avoids litigation in the Japanese courts (and conversely, from your Japanese partner's point of view, avoids litigation in American courts). It should be specified in the arbitration clause exactly where the arbitration is to be held and which law will govern disposition of the substantive and procedural issues involved in the dis-

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[3] Before August 1971, when the yen was revalued to 308 yen (central rate) to the dollar, the yen had been pegged at 360 yen to the dollar, the parity rate established with the International Monetary Fund in May 1953. Since February 13, 1973, the yen has been floating and the exchange rate has fluctuated between a low of 306.30 yen to the dollar and to a high of 259 yen per dollar.

[4] Under present Japanese foreign exchange regulations, proceeds from the disposition by the foreign investor of shares of the Japanese corporation may be repatriated if such proceeds are deposited directly into a nonresident free yen account of such investor.

[5] The only condition for remitability of proceeds from the disposition of validated shares is that the price at which the shares were sold is "fair." Determination as to whether the price is fair or not is left to the foreign exchange bank. In case there should be any uncertainty as to the fairness of the price, the matter should be referred to the Bank of Japan. Thus, the safest way to ensure remitability of the proceeds would be to obtain the Bank of Japan's informal clearance in advance.

[6] Japanese government approval (validation) of the license agreement normally contains the following condition: "In case the subject agreement should be canceled, suspended, or terminated due to expiration of its term, report to that effect shall be made to the competent ministers without delay." Pursuant to this condition, the termination of the license agreement must be reported to the relevant ministers through the Bank of Japan.

[7] Despite the prevalence of arbitration clauses in Japanese — U.S. commercial agreements as a means of resolving disputes, it still may be true that a formal arbitration proceeding may be even more rare than a lawsuit in trans-Pacific transactions. The overwhelming majority of disputes are settled informally without resort to court or arbitration.

pute. The results of the arbitrator's decision can be enforced by the courts of either country.[8]

The overriding cause of joint venture termination is, of course, lack of business success, the causes of which may include:

(1) *Lack of Clear Understanding Between the Parties*

One must be wary of the unarticulated assumptions of both parties when they entered the joint venture. In Japan, there is a distinct need for accurate communication. The partners should work out a document detailing the plans and anticipations of the parties and a guide for united action. It is vital that the necessary mutuality exist from the beginning. The American partner should not attempt to oversell the potential of his products.

(2) *Lack of Compatibility Between the Parties*

The key element in a successful joint venture is having the right partner. You should note that geography plays an important part in influencing the behavior and attitudes of persons from different parts of Japan. Furthermore, before the venture agreement is finalized, the American partner should be certain that his future partner does not have other business interests that might conflict with the interests of the joint venture.

(3) *Lack of Independent Status of the Joint Venture*

Ideally, the joint venture should have its own personality, separate and distinct from that of the Japanese partner. This is often hard to accomplish when the venture is staffed with personnel of the Japanese partner; it is hard for these employees to differentiate the joint venture's interests from those of the Japanese parent. For example, in the area of marketing, the temptation will be to allow the Japanese parent to handle the export sales distribution or replacement sales. Should this occur, accounting techniques should be used which carefully delineate the profits of the venture and keep them separate from the profits of the Japanese partner. Provisions

[8] Art. IV(2) of Treaty of Friendship, Commerce and Navigation between the United States and Japan of 1953; also U.N. Convention of 1958. Under the Japanese Code of Civil Procedures, the arbitration award has the same effect as a final judgment and can be enforced by execution judgment; Arts. 800, 802. *See*, *American President Lines v. C. Subra KK* (Tokyo Dt. Ct., Oct. 23, 1959), translated in 6 JAPAN ANN. INT'L L. 203 (1962); *Casaregi Compagnia Di Navigazione E Commercio SPA v. Nishi Shoji KK* (Tokyo Dt. Ct., Aug. 20, 1959), translated in 5 JAPAN ANN. INT'L L. 112 (1961).

should be made in the joint venture agreement for an audit of these operations by the American partner or by a third party.

(4) *Other Business Reasons*

Other reasons for the termination of a joint venture, which from past history and experience are identifiable, include lack of sufficient sales, lack of profits, failure of the venture to carry out its most important obligations under the license agreement, stalemate within the board of directors, failure of the parties to agree on the budget for the future or on past financial statements, and bankruptcy of one of the partners in the venture.

These reasons are immediate, factual, and identifiable. Those specified in the preceding three paragraphs are more fundamental. All underly the catch-all reason for joint venture failures — namely, lack of business success.

Conclusions

Don't be in too much of a hurry to enter into a Japanese marriage. If it becomes necessary to extricate yourself from a joint venture your Japanese partner generally will have more leverage than you in accomplishing that extrication, if not successfully, at least with a minimum of adverse consequences, if only because he is playing on his own home ground.

Take your time in selecting your partner; develop criteria for your future partner and be sure that these criteria are met.

Take your time in negotiating your venture agreement. Remember that your prospective partner's nod in a negotiation may be merely a mark of politeness and not an indication of understanding. Full use should be made of a translator if there arises any doubt. Absolute mutuality of understanding concerning the objectives and operation of the joint venture and concerning the responsibilities of each of the partners is the basic objective which must be fully met for success to be achieved. Considerable patience must be part of your arsenal. Distance, language barriers, and the typical turnovers in American personnel make a subsequent understanding far more difficult to achieve if an initial understanding has not been reached at the beginning.

You can afford to be selective and cautious in expanding operations into Japan which just is not as attractive an area for investment as it once was. It's infrastructure, the best example of which is probably the distribution system, requires much further development. It is a relatively high cost area in which to operate; wage rates and fringe benefits, for example, are exploding at the rate of about 25 percent per year.[9] It also has all of the problems associated with highly developed industry, such as pollution and the energy shortage. There is also an acute shortage of available land. Furthermore, Japan's lack of natural resources and overcrowding accentuate the problems which modern industry faces all over the world. The prospects for success of a new business enterprise in Japan have fallen considerably in the last few years except for those situations where the foreign investor is able to fill a special need in Japan or supply desired technology.

Above all, protect your technology. Watch your patent situation closely and police it carefully. The Japanese respect patents, and your patent situation at the outset will be a key factor in determining what kind of deal you get with your Japanese partner. It is your basic lever, and technological virginity is normally a prerequisite to any successful venture. Hopefully, your patent position will adequately protect you from competition in patented items from your former partners when the joint venture is terminated.

Finally, even though you will probably have to go the joint venture route in Japan for logistical, cultural, and other reasons, you will want to try to get as much equity ownership as possible and an equal voice in critical business decisions. Maximization of your equity position will afford you a decided influence on the operation of the joint venture, will aid you in taking corrective steps in the event the situation does not progress according to your expectations, and will increase your leverage in the event of a breakup. In short, you should have as many votes on your side as possible when the crunch comes and you need them.

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[9] According to an estimate of the Economic Planning Agency of Japan, the average increase in the level of wages since April 1974 was 31.9%.

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