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The Concept of a Joint Venture and the Legal Context for Joint Ventures in CMEA Countries

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I. THE MEANING OF THE TERM "JOINT VENTURE"

The use of the term "joint venture" is not confined to East-West economic relations. The term gained worldwide usage long before it became fashionable in Eastern Europe. This concept does not, however, have the same meaning to all those who use it.

In the broadest sense, the concept "joint venture" is understood to include all forms of agreements through which "the operation of two or more firms are partially, but not fully, functionally integrated in order to carry out activities in one or more areas."[1] This may consist of simple buying or selling operations, development and production of natural resources, or research and development and construction projects.[2]

In its narrow meaning, the term "joint venture" is reserved for operating joint ventures defined as:

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1. Organization for Economic Cooperation and Development, COMPETITION POLICY AND JOINT VENTURE 11 (1986).

2. *Id.*

> [A] partnership through which two or more firms create a separate entity to carry out a productive economic activity, in which each partner takes an active role in decision making. Each party to the "operating joint venture" makes a substantial contribution in the form of capital and technology, marketing experience, personnel or physical assets. The partners may also contribute access to their respective distribution networks.[3]

Given the different interpretations of the term "joint venture," it would be a futile exercise to attempt to formulate a definition of a "proper" international joint venture.

It is interesting to note in this context, however, that the use of this term in Council for Mutual Economic Assistance (CMEA) countries, as evidenced by national reports, is reserved for the particular relationship between a local and foreign party in which a new separate entity is created. In terms of the other commonly used distinction between equity and non-equity joint ventures only the first type seems to be accepted as the "real thing" according to the legislation of those countries.[4]

Although widely used, the term "joint venture" has no special legal meaning in CMEA countries whose laws provide a choice of legal forms for entities formed by local and foreign partners. An exception is the Soviet Union, whose law defines a joint venture as a form of a corporate entity that can be established by foreign and local investors only.

The term "joint venture" usually is used in the broader sense in CMEA countries. Since at the earlier stage of foreign equity investment in these countries only joint ventures with local partners were permitted, the term "joint venture" became synonymous with "foreign investment."[5] Thus wholly owned foreign subsidiaries, the formation of which is now allowed in a number of CMEA countries, are sometimes indiscriminately called "joint ventures."

II. Evolution of Legislation

European CMEA countries are latecomers to the international investment market. The first country allowing foreigners to operate

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3. Harrigan, *Joint Venture and Global Strategies*, 19 COLUMBIA J. WORLD BUS. 7-16 (1984).

4. Burzynski & Juergensmeyer, *East-West Industrial Co-operation: The Polish Example*, 1 LOY. L.A. INT'L & COMP. L. ANN. 37, 38-39 (1978).

5. *Id.* at 39.

inside its economy was Romania in 1971. Law No. 1 of that year allowed the formation of joint ventures by Romanian enterprises and foreign firms. It was followed in 1972 by two decrees: No. 424 on the constitution, organization and operation of joint companies,[6] and No. 425 regarding tax on profits of joint companies.[7] Among the laws of CMEA countries regulating foreign investment, Romanian law is the most stable one. It has not been changed for the last 18 years.

In contrast, Hungarian law on foreign joint ventures has been frequently changed. The first Decree No. 28 of 1972, which enables ventures on economic associations with foreign participation, was amended in 1977, 1978, 1979, 1982 and 1985.[8] At the end of 1988, the Hungarian Parliament passed two new laws regulating foreign investment, Act VI of 1988 on Economic Associations and Act XXIV on Foreign Investment in Hungary.[9] Both laws entered into force on January 1, 1989.[10]

Poland decided to invite foreign investors in 1976. However, only small foreign businesses, limited both in scope and size, were invited. Ten years passed before the Polish legislature enacted a law allowing major foreign investment. The law of April 23, 1986, entitled *The Companies with Foreign Participation*, was, however, short-lived. On December 23, 1988 it was replaced by the Law on Economic Activity with the Participation of Foreign Parties (Foreign Investment Law) which presently provides the legal framework for all foreign investment in Poland.[11]

In Bulgaria, joint ventures with foreigners became possible under Decree No. 535 of 1980 on economic cooperation between Bulgarian juridical persons and foreign juridical and physical persons. This De-

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6. U.N. ECONOMIC COMM'N FOR EUROPE, EAST-WEST JOINT VENTURE CONTRACTS, U.N. Doc. ECE/TRADE/165, U.N. Sales No. E.88.II.E.30 (1988) at 135-39 [hereinafter CONTRACTS]. The Decree is published in the Official Bulletin of the Socialist Republic of Romania, No. 121/1972. *Id.* at 135.

7. *Id.* at 140-41. The Decree is published in the Official Bulletin of the Socialist Republic of Romania, No. 121/1972. *Id.* at 140.

8. U.N. COMM'N FOR EUROPE, EAST-WEST JOINT VENTURES— ECONOMIC, BUSINESS, FINANCIAL AND LEGAL ASPECTS at 148-154, U.N. Doc. ECE/TRADE/162, U.N. Sales No. E.88II.E.18 (1988).

9. Act VI is reproduced in CONTRACTS, *supra* note 6, at 85-106. Act XXIV is reproduced in CONTRACTS, *supra* note 6, at 102-16.

10. *Id.*

11. The Law of December 23, 1988 on the Economic Activity with the Participation of Foreign Parties, 1988 Dziennik Ustaw [hereinafter Dz.U.] 1988 No. 41, item 325, as amended Dec. 28, 1989, 1989 Dz.U. No. 74, item 442. See English text in CONTRACTS, *supra* note 6, at 121-132.

cree was amended in 1987 by Decree No. 31 on the economic activity of self-managing economic organizations with foreign investment participation and through Decree No. 2242 on free trade zones.[12] It was finally repealed in January 1989, by Decree No. 56 on economic activity.[13]

In the Soviet Union, East-West joint ventures were authorized by two decrees of 1987: The Decree of the Presidium of the USSR Supreme Soviet of January 13, 1987 concerns the establishment and operation of joint ventures in the USSR, international amalgamations and organizations with the participation of Soviet and foreign organizations, firms and management bodies,[14] and Decree No. 49 of the USSR Council of Ministers of January 13, 1987 deals with the establishment and operation of joint ventures in the USSR with the participation of Soviet organizations and firms from capitalist and developing countries.[15] On September 17, 1987, these decrees were amended through Decree No. 1974 of the Council of Ministers regarding further measures needed to carry out external economic activities in the new conditions of economic management. This, however, did not complete the process of shaping the legal regime of joint ventures. On December 2, 1988, additional amendments were introduced by Decree No. 1405 of the USSR Council of Ministers, On the Further Development of the External Economic Activities of State, Cooperative and Other Public Enterprises, Amalgamations and Organizations.[16]

The latest of the European CMEA countries to authorize joint ventures with foreign investors is Czechoslovakia. On November 8, 1988, Czechoslovakia enacted Law No. 173, On Enterprises with Foreign Property Participation.[17] No legislation allowing joint ventures has thus far been passed in the German Democratic Republic.

III. The Main Functions of Joint Venture Legislation

Multiple and complex reasons exist for the late start and guarded approach to foreign investment in CMEA countries. Political apprehen-

12. Decree No. 2242 is reproduced in English in CONTRACTS, *supra* note 6, at 60-2.

13. *Id.* at 41-59.

14. This is Decree No. 6362-XI. *See id.* at 145.

15. Decree No. 49 of the USSR Council of Ministers on the Establishment in the territory of the USSR and operation of the Joint Ventures with participation of Soviet organizations and firms from capitalist and developing countries, in 1987 Sobranie Postanovlienii i Pravietel'stva SSSR [SP SSSR], no 9, item 40. See English text of Decree No. 49 in CONTRACTS, *supra* note 6, at 146-52.

16. *See* CONTRACTS, *supra* note 6, at 153-4.

17. *Id.* at 65-71.

sions were an important factor. The memories of largely negative experiences with foreign capital operations in their economies during the pre-war period were large. They were compounded by the post-war mistrust of the post-war period toward everything that was ideologically alien.

The economic system that developed in these countries during the post-war period was quite hostile toward any form of direct foreign participation in their economies. The vast majority of industrial, commercial, transportation, and service enterprises, together with natural resources, became State or cooperative owned. Consequently, the legal and administrative framework for the economic life that was formulated during that period concentrated almost exclusively on regulating the organization and conduct of economic activities of the state-owned enterprises or cooperatives leaving little room for private initiative. As the result of this approach, plans for the supply and distribution system, pricing, tax, and financial controls were founded upon the premise that the socialized enterprises, either State or co-operative owned, were the only actors on the economic stage. These factors, plus the autonomous pricing system and non-convertibility of the CMEA countries' currencies, rendered any calculation of production cost or estimation of profits and losses very difficult. The economies of these countries developed into ones which foreign investors neither could nor cared to enter.[18]

The successive foreign investment regulations borne out of political will and prompted by economic necessities to attract foreign capital, skill, and know-how have had to perform a very difficult task. The regulations had

> — to provide host state administration with adequate instruments of control over the admission of foreign investors and their operation inside the country's economy enabling it to prevent or quickly weed out unwelcome activities,
> — to encourage foreigners to consider investments and assure them that their rights and property would be well protected, and
> — to create conditions enabling foreign investors to operate inside the economic and legal system alien and unprepared to cater to the needs of non state-owned, private entrepreneurs . . . in the way most beneficial for the host country's economy.[19]

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18. Burzynski & Juergensmeyer, *Poland's New Foreign Investment Regulations: An Added Dimension to East-West Industrial Cooperation*, 14 VAND. J. INT'L. 17, 26-30.

19. *See generally* laws concerning joint ventures cited *supra* notes 6, 7, 9, 11.

Simultaneous attainment of these goals proved to be quite a formidable task as is evidenced by the frequency with which the legislation on foreign investment in CMEA countries has been changed.

It would be a great oversimplification, however, to interpret this phenomenon only as the manifestation of dissatisfaction with the results obtained so far. The underlying factor that makes subsequent modifications of the legal framework for joint ventures possible and sets their pace in each of these countries is the process of changes launched recently in CMEA countries. Consequently, these regulations should be viewed primarily as proof of evolution affecting the political, economic and legal structures of CMEA countries.

IV. Governmental Controls over the Formation and Activities of Joint Ventures

Governmental control over the admission and activities of foreign investors is not an invention of CMEA countries. It is known and practiced also in many western European countries. In some of these countries, the governments reserve some measure of control under specific foreign investment acts.[20] In other countries, it is exercised under general procedures which have to be followed by anyone interested in obtaining the right to invest in the country.

Securing adequate governmental controls is also one of the main functions of CMEA countries' legislation allowing joint ventures. There has been, however, an interesting evolution in the approach to that problem.

A common feature of the "first generation" of laws on foreign investment was the requirement of governmental approval for any joint venture project. In order to obtain the approval, interested parties had to file an application together with the supporting documents. The application had to be submitted to a designated Ministry, Council of Ministers,[21] or State Council.[22] The approval of the appropriate governmental body also usually was required for the transfer of shares in the joint venture.[23] As a general rule, all legislation placed a forty-nine to fifty percent ceiling on the foreign share in the equity of joint ventures. Another common feature of early joint venture legislation

20. For instance in Greece, Italy, Portugal, Spain and Turkey.
21. In Bulgaria under article 5 of the Decree No. 535.
22. In Romania under article 17 of the Decree No. 424. *See supra* note 6.
23. With the exception of Bulgaria.

in CMEA countries[24] was the requirement for the management of joint ventures to include nationals of the host country.[25]

The changes introduced to joint venture legislation in many CMEA countries at the end of 1988 indicate a tendency toward greater flexibility in providing for governmental control over joint ventures. In Bulgaria and Hungary an approval by the competent authorities is necessary only if Western participation in a joint venture is more than fifty percent.[26] The registration procedure was simplified and shortened. The time limit for the approval was set by the laws of Poland at sixty days and by Czechoslovakia at ninety days. In Hungary, an application is automatically regarded as approved if not rejected within ninety days.

Also, the proportion of shares allowed to be held by foreign companies has been liberalized. In Bulgaria, Poland, and Hungary, foreign investors may form wholly-owned subsidiaries. There is no limit imposed by law on foreign shareholdings in the USSR and in Czechoslovakia. In Hungary and Poland, joint ventures between foreigners and nationals or companies formed by them are permitted in addition to the joint ventures with state enterprises and co-operatives. The new legislation in Bulgaria, Czechoslovakia, Poland, the USSR, and Hungary allows management of joint ventures to be in foreign hands.

V. PROTECTION OF RIGHTS AND PROPERTY OF FOREIGN INVESTORS

The liberalization of government controls over joint ventures in many of the CMEA countries gives foreign investors greater flexibility in structuring the equity of their joint ventures, appointing their managers, and selecting their partners. In addition, originally the laws of Hungary and Poland, and more recently Bulgaria and Czechoslovakia expressly provide these guarantees to foreign investors.

Article 106 of the Bulgarian Decree No. 56 provides:

> (1) Investments made by foreign persons shall not be subject to confiscation or expropriation through administrative procedure.

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24. Except for Hungarian legislation.

25. For example the Polish Law of April 23, 1986 on Companies with Foreign Capital Participation, 1988 Dz.U., No. 17, provided in art. 17 that the company's manager, and in case of a board of management, its president should be a Polish citizen who is a permanent resident in Poland.

26. Decree No. 56 on Economic Activity of January 9, 1989 issued by the State Council of the People's Republic of Bulgaria, Act No. XXIV of 1988 on Foreign Investment in Hungary. For English text *see* CONTRACTS, *supra* note 6, at 107-18.

(2) Foreign persons' investment in real estate cannot be expropriated except for state or public needs which cannot be met otherwise.

(3) An expropriated investment shall be made to foreign person by agreement. Should no agreement be reached, the amount of compensation shall be determined by the district court.[27]

Section 22 of the Czechoslovakian Act No. 173 provides:

(1) The property of the enterprise on the territory of the Czechoslovak Socialist Republic may be expropriated or its property rights may be restricted only on the basis of law.

(2) If measures under paragraph (1) hereof are taken, the foreign participant shall receive a prompt compensation corresponding to the actual value of its property at the time when the property was affected by these measures; the compensation shall be freely transferable abroad in the currency in which the foreign participant paid its contribution to the statutory capital of the enterprise or, in other cases, in the currency of the country in which the foreign participant has its registered office or domicile.[28]

Section 1 of Hungarian Act XXIV provides:

(1) Investment by foreigners in Hungary shall enjoy full protection and safety.

(2) The foreign investor shall be promptly indemnified for any damage arising from any possible measure affecting his property, such as nationalization, expropriation or any measure having similar legal effect. Compensation shall be paid at actual value.

(3) The State shall see to it that indemnification be effected by that State-administration body which took the given measure. In case of infringement of law, revision of the decision of the State administrative body may be requested from the Court.

(4) The amount of compensation shall be paid to the person entitled to it in the currency of the investment.[29]

Article 22.6 of the Polish law of December 23, 1988 provides:

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27. CONTRACTS, *supra* note 6, at 41, 56.
28. *Id.* at 65-71.
29. *Id.* at 107-16.

> The Minister of Finance, upon the application of the foreign Shareholder, issues him with a compensation payment guarantee in an amount equal to the value of the Company's assets due him, in the event of a loss resulting from a decision of any State authorities in respect of nationalization, expropriation, or from other actions having a result similar to that of nationalization or expropriation.[30]

Increasing legislation containing guarantees against expropriation is evidence of the growing awareness among CMEA countries that inviting foreign investors without assuring them as to the security of their investment will not work. This also explains their interest in entering into investment protection and guarantees agreements with capital exporting countries.

Apart from the fear of sudden expropriation, foreign investors are also very sensitive to foreign exchange restrictions which exist in all CMEA countries. The regulations on joint ventures in these countries contain guarantees as to the transfer of profits and capital abroad. With the exception of Hungary, however, in all CMEA countries foreign investors can only transfer abroad the amount in foreign currencies earned by their joint ventures. However, Article 20.4 of the Polish Law of December 23, 1988[31] provides the possibility for a foreign investor to transfer profits earned in local currency upon permission from the Minister of Finance. Under Article 21.2 and 21.3 of the same Law a foreign investor has the right to transfer abroad, without a separate foreign exchange permit, proceeds from the sale of his shares even if they were received in Polish currency.[32] The transfer, however, must take place no earlier than ten years from the date of registration of the joint venture.[33]

VI. The Status of the Joint Venture in Legal and Economic System of the Host Country

The legal systems of the CMEA countries were largely unprepared to serve the needs of joint ventures. Until recently the only major economic entities in these countries, state enterprises, were created by administrative decisions. There was little use for company laws, mostly enacted in the pre-war period and therefore looked upon with suspicion. Contractual law also was organized in two parallel systems,

30. *Id.* at 121, 127.
31. *Id.* at 121, 126.
32. *Id.*
33. *Id.* This is Art. 21.3 of the law. *Id.*

one containing the norms applicable to "economic" contracts between state owned enterprises, and the other for contracts with individuals. In order to "plug" joint ventures into this system, the old company laws had to be resuscitated. In the case of the Soviet Union, where such law did not exist, joint venture law had to fill the void. The legal situation of joint ventures then had to be assimilated either to that of state-owned enterprises or of individuals. It can be best illustrated by two examples from the Polish legislation.

Article 29 of the 1986 Law provides, "The company pays taxes and levies as well as enjoys tax allowances and exemptions in accordance with provisions on taxation of *units of socialized economy*, taking into account changes resulting from the present Law."[34] Meanwhile, article 27 of the Law of 1988 replaces it with the following rule: "The company shall pay the following taxes: turnover tax, corporate tax, agriculture tax . . . . It is entitled to relief and exemptions therefrom in accordance with the principles applicable to *non-socialized economic entities* enjoying legal personality."[35]

The same technique had to be used in order to determine the place of joint ventures in the national economy. Knowing foreign investors' tendancies toward economic planning, most of the foreign investment laws formally considered joint ventures as independent of the economic planning and administrative systems of the host country. This position was taken by the laws of the Soviet Union, Bulgaria, Czechoslovakia, Hungary, and Poland. However, regarding domestic purchases, the same laws, with the exception of the Soviet Union, put joint ventures under the same conditions as state-owned enterprises.

Economic reform that is currently under way in some of the CMEA countries should render all of the problems connected with determining the status of the joint venture in the legal and economic system of Poland obsolete. Once the distinction between the rights and duties of state owned enterprises and other entities representing different forms of ownership is removed, the need for specific provisions determining the position of joint ventures will also disappear.[36]

34. Dziennik Ostow (Journal of Laws) of 1986 no. 17 item 82.
35. CONTRACTS, *supra* note 6, at 121, 128.
36. Burzynski & Juergensmeyer, *supra* note 18, at 48-9.