

SPECIAL SECTION



DOING BUSINESS IN ASIA

Exit Strategies

Companies in joint ventures need to prepare for a parting of the ways

By William Zheng

The simmering dispute between Wahaha, one of China's largest beverage makers, and Groupe Danone, the French food conglomerate, has once again placed the relationship between domestic and foreign joint-venture parties in China under the spotlight.

Similar to a marriage, joint-venture relationships can make for a perfect match at the beginning, only to take a wrong turn, for one reason or another, years later and wind up with one or both parties looking to escape the arrangement. In an effort to avoid the Wahaha and Groupe Danone situation, a well-drafted joint-venture contract should address many of the key concerns of the parties, including proper exit strategies when the joint-venture entities are no longer satisfied with each other's cooperation.

Today, a joint venture remains a popular entry vehicle for foreign companies seeking to gain a footing into the expanding China

market. Due to various restrictions in certain sectors of the Chinese economy, joint ventures at times are the only choice for foreign companies. But joint ventures are also generally an ideal choice for any foreign company that has no previous experience doing business in China. Over time, the experience that the foreign company will gain under a joint venture could ultimately allow it to open a wholly owned enterprise in China.

China has been the recipient of a major injection of direct foreign investment for many years. But unlike the joint venture between Wahaha and Groupe Danone, which stretches back to 1996, more recent ventures often include various mechanisms for protecting both parties and providing exit solutions.

Laws in China require certain activities, such as changing of the registered capital and board of directors of a joint venture, to be unanimously approved by joint-venture parties. This could prove to be a disadvantage for foreign parties who are minority shareholders in a joint venture since they are often left with no decision-making power on any other matters. Due to the fact that Chinese

laws are silent as to the limitation of the activities that require unanimous approval in a joint venture, one solution is for foreign parties to include items to the unanimous approval section of the joint venture contract, which will ensure that their interests are fully protected.

The recent fallout between Wahaha and Groupe Danone is hardly unprecedented in China. Many joint ventures were created in the late 1990s, and by 2005 we have started to witness the negative sides of such arrangements, including the breakup of some of these joint ventures. At the time that these ventures were created, the issue of exit strategies was often omitted or never discussed. Therefore, when one of the parties decides to exit from the joint venture, upon the failure of reaching a mutual agreement, it may have no choice but to seek proper remedy in court.

Exit strategies have now become an important part of any joint-venture contract. Lawyers will often spend just as much time negotiating over the proper exit strategy as they do with the major joint-venture arrangement. This is due to the fact that, depending

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on the nature of the contribution made by the foreign parties, the proper exit strategy might not be as simple as dividing up the company based on ownership percentage.

In many joint ventures, for example, foreign companies will provide technology as part of their contribution. But that can collide with Chinese laws that specify that the ownership of the improvement made upon the underlying technology belongs to the joint-venture company rather than the foreign partner. This can lead to problems if the issue is not adequately addressed in the joint-venture contract. In some cases, we have seen situations in which foreign parties have lost the entire improvement based upon the technology they have contributed. In essence, this has allowed Chinese companies to gain free ownership to such technology. Thus, it is critical for parties to agree on the precise ownership of technology improvement in the event of a dissolution of a joint venture.

A little bit of procedural finessing may

also be required when it comes to negotiating the details of joint ventures. Current laws in China require joint venture contracts to be registered and approved by the government's Administration of Industry and Commerce (AIC). This agency, however, does not like to review long and comprehensive contracts and normally will only approve those that are based on a standard joint-venture contract. In order to include protection mechanisms and exit strategies in a contract and still have it approved by the AIC, consider addressing all of those issues in an attachment to a standardized contract. Because the AIC will likely only review the main contract document, joint venture parties may be able to rely on the arrangements in the attachment, which will likely not be reviewed in detail. While such an arrangement cannot guarantee a successful approval in each instance, there have been many successful precedents.

Finally, it's difficult to talk about joint ventures in China without discussing the strategy

of negotiating with Chinese parties. Foreign companies should keep in mind that, regardless of what the Chinese companies agreed to at the negotiation table, the trump card for the domestic company may well be a local government agency that may not necessarily uphold the details of the joint-venture arrangement. We've also seen situations in which Chinese companies used their connections with local authorities to reject a fully negotiated joint-venture contract. The lesson to be learned? A joint venture is not a done deal until the joint venture contract is approved by the local AIC.

In general, joint ventures remain a popular and successful way for foreign companies to gain a foothold in China. But it is important to address many of the critical concerns of the foreign parties in order to make sure their interests are protected. Gone are the days when a standard joint-venture contract would be sufficient to protect the interests of the business partners. ■