

**LEGAL PERSPECTIVES OF JOINT VENTURE COMPANIES IN
DEVELOPING COUNTRIES: A CASE FOR TANZANIA.**

**Thesis submitted for the degree of
Doctor of Philosophy
at the University of Leicester**

by

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DEDICATION

In Memory of my mother, the late Angelina Peter Bakagorwaki.

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Audax Peter Rutabanzibwa

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CHAPTER ONE.

INTRODUCTION.

1:1. PROBLEM.

Despite the post cold war economic interdependence, trade liberalisation and privatisation, some developing countries still face problems of lack of managerial skills, technical know-how and investment capital. These important needs can only be satisfied with the co-operation of transnational corporations. TNCs are eager to exploit the benefits of trade liberalisation and privatisation and acquire abundant cheap labour and raw materials from developing countries. However, because of lack of knowledge on local social and political conditions, and local markets and distribution networks, TNCs are hesitant to invest in developing countries on their own. Joint venture companies between TNCs and companies from developing countries are seen as a co-operative mechanism which can enable both TNCs and companies from developing countries achieve their respective objectives.

The formation of joint venture companies requires a legal framework which ensures that interdependent and co-operative elements between parties exist and are protected. Thus, it is important before parties decide to form a joint venture company to ensure that elements of complementary objectives and inputs, joint control, and profit and loss sharing exist between them, and that they are maintained in a given legal framework. Appropriate joint venture companies can be attained by the use of a company legal structure if trade law, in particular company law, reflects the above mentioned co-operative elements. In other words, company law must ensure that the interests of all parties to the joint venture company can be protected so that their objectives are attainable. The current company law of developing countries may not reflect these elements.

1:2. AIMS AND OBJECTIVES.

This research attempts to study some relevant aspects of company and trade law with the aim of analysing whether they contain the necessary elements for the formation and operation of joint

venture companies. Its objective is to develop a legal framework for joint venture companies being formed in developing countries. This will in turn help developing countries to determine whether the joint venture company mechanism is appropriate for the attainment of development.

1:3. APPROACH.

This study consists of seven chapters. Chapter two traces the historical background of joint venture companies in developing countries and the reasons for their establishment. It also develops the meaning of a joint venture, including its key elements. The last part of the chapter discusses different legal structures which joint venturers may decide to adopt. These include: contracts, partnerships and corporate structures. Their adoption may result in contractual joint ventures, joint venture partnerships and joint venture companies respectively. The advantages and disadvantages of these structures are also discussed.

The third chapter makes an inquiry into corporate legal theory. It aims to analyse whether and how this theory can accommodate the joint venture company phenomenon. The chapter analyses the orthodox corporate theories, namely, the entity theories and the aggregate of contracts theories. The applicability of these theories to joint venture companies is doubtful mainly because they are based on the 19th century business structures which were characterised by individualism rather than co-operation. The chapter finally analyses developments in the new approach, namely, the relational approach which is aimed at meeting the challenges of modern business associations like joint venture companies.

Based on the relational approach the fourth chapter analyses whether company law provisions and doctrines are able to regulate the formation and operation of joint venture companies. To this effect the chapter uses examples from English and Tanzanian Company Statutes. It discovers that unlike Tanzanian Company Law, English Company Law is developing towards the relational approach. However, neither law is found to be well equipped to address the problems of cross-national joint venture companies.

Chapter five analyses whether International Trade Law is able to address the problems of cross-national joint venture companies. In this chapter the notion of co-operation is analysed in its wider context, namely, whether there are international co-operative efforts aimed at developing a legal framework for cross-national business structures, including joint venture companies. The efforts of the United Nations toward the formulation of Codes of Conduct to TNCs are discussed. Regional efforts to the same effect are also analysed. However, the study limits itself to the

development of transnational Company Law of the European Economic Community (EEC), the Eastern, Central and Southern African Free Trade Area (PTA) and that one of ASEAN countries.

Chapter six is a case study on Tanzanian joint ventures and the law. Six joint venture companies established with the participation of TNCs are analysed. The analysis addresses itself to the law which governs their formation and operation. It is discovered that because of inadequacies in the law, apart from using Company Law Statutes, members of these companies use different agreements to protect their mutual interests. The commonly used agreements include: joint venture shareholders agreements, management agreements and technical services agreements. These are also analysed.

Chapter Seven draws conclusions from the study, namely that: the assumption that the current company law is able to regulate the formation and operation of modern business enterprises like joint venture companies should not be exaggerated. Company Law, especially that of developing countries such as Tanzania, needs modification to reflect relations in modern business associations which are based on co-operation. Further, that as the number of cross-national business associations increases, so does the need for co-operative international effort to harmonise existing national laws and develop new laws to allow cross-national joint ventures to operate effectively both nationally, and internationally.

CHAPTER TWO

THE NATURE AND EXTENT OF JOINT VENTURES

2.1. HISTORICAL BACKGROUND OF JOINT VENTURES IN DEVELOPING COUNTRIES.

2:1:1 Introduction.

After a long period of stagnation, mistrust, hostility, colonisation and underdevelopment, Bernard Shaw's view that "we must trade and travel and come to know each other all over the habitable globe" seems particularly apposite in the second half of the 20th Century¹. Although co-operation using joint venture forms between developed and developing countries marks the last stage of this rather gloomy period, one persistent characteristic throughout all the stages is the movement of capital across national boundaries. The conduct of business across state boundaries, whether in joint venture forms or otherwise, causes new and complex legal problems. These problems do not arise in a vacuum. They should be viewed in the context of socio-economic and other value processes taking place in the international community².

Joint venture formation in developing countries is not the first use of this device in the history of inter-corporate relationships. For more than three decades corporations in countries with developed market economies have been forming joint ventures *inter-se*³. Already in the 1970s the socialist countries of Eastern Europe had started to have an increasing awareness in the inter-block economic co-operation⁴. The 1980s witnessed structural changes and adjustments in their economies aiming at liberalising their economies to allow the formation of joint ventures with

¹Bernard Shaw The Intelligent Woman's Guide to Socialism and Capitalism, (1928), London: Constable and Company Ltd., p. 157; Marc Maresceau (Ed), The Political and Legal Trade Relations Between European Community and Eastern Europe, (1989), Dordrecht: Martinus Nijhoff Publishers at p. xi.

²Mukoyogo M.C, Conflict of Corporation Law: The Personal Law of Juridical Persons: A Case of Tanzania, (1983), Ph.D Thesis: University of Konstanz, at p. 3.

³Killing Peter, J., Strategies for Joint ventures Success, (1983) London: Routledge, at p. 3; Note, 'Joint venture Corporations: Drafting the Corporate Papers', 78Harv.L.Rev., (1931), 339; Machem, 'The Law of Joint ventures', 15Minn.L.Rev., (1931), 644; Young G. Richard and Bradford, Standish, Jr, Joint Ventures: Planning and Action, (1977), New York: Financial Executive Research Foundation.

⁴UN, Joint Ventures as a Form of International Co-operation. (1989), New York: Tylor & Francis, at p.27; Marc supra n. 1 Part Two pp. 111ff.

capitalist corporations⁵. After fundamental socio-economic changes in Eastern Europe, towards the end of 1980s, one cannot resist optimism that more joint ventures between corporations of Western and Eastern European countries will be one of the biggest forms of business enterprises in the 21st century.

Foreign Direct Investment (FDI) in developing countries during 1960s took the form of subsidiary enterprises of TNCs, many of these were established before developing countries had attained their political independence. Towards the beginning of 1970s most of developing countries were of the view that transnational affiliates were not solving their economic problems. Some countries which had market economies adopted stricter policies against FDI, and in those which followed planned economies, the subsidiaries could not escape nationalisation or forced joint ventures⁶. As a result of this, TNCs stopped investing in those countries which they considered more risky⁷.

However, developing countries, through co-ordination in their organisations (e.g. The group of seventy seven, The Conference of Non-aligned Nations, the ACP, etc.), were able to table their economic grievances in different international fora. Their grave concern has been to ensure that their development goals, national identities and purposes are not distorted by the global strategies of TNCs, and to make sure that these corporations do not reap more than they invested⁸. For example, during several 'rounds' of the GATT, developing countries have been pressing for multinational negotiations on favourable terms and conditions, not only on tariffs but also on the removal of other barriers of trade so as to widen the scope of the GATT to include their economic interests⁹. Generally, international fora are used by developing countries as a means of securing special and preferential treatment in foreign trade.

Another forum used by developing countries is the United Nations Conference on Trade and

⁵UN *ibid.* Ch. III. Joint venture Laws to that effect were enacted in these countries, issued in Decrees. For example, in Bulgaria it was Decree No. 535 of 1980, Hungary Decree No. 34 of 1986, Poland Law of 23rd April 1986, and Russia Law of Jan. 13th 1987. However, the speed of joint venture companies formation is currently slowing down in Eastern Europe mainly because the legal foundations of private (individual) property are not yet clear, for further discussion see Frydman Roman and Rapaczynski Andrzej, Privatisation in Eastern Europe: Is the State Withering Away?, (1994), Budapest: Central European University Press.

⁶Bolton D. Nationalisation - A Road to Socialism? The Lessons of Tanzania, London: Zed Books; Tem P. 'Nationalisation in Tanzania', IVE.A.L.J. (1967), 35; Delson Robert, 'Nationalisation of the Suez Canal Company: Issues of Public and Private Law', 57Columb.L.Rev. (1957), 755-796.

⁷Morgan, D.S, 'Perception of European Entrepreneurs on Investment Opportunities in Sub-Saharan Africa', Industry Africa: Journal of Industrial Development, UNIDO No. 1 of December 1989, at p. 4-5.

⁸UN, Transnational Corporations in World Development, UNCTAD Report, (1978), UN: New York, at p. 103; UN (ECA), Investment Africa, No. 1 December, (1983), at p.3.

⁹UN (ECA), 'GATT Multinational Negotiations', African Trade, No. 3, 1/4 (1979) p. 8; James Pickett (Ed.), Towards Economic Recovery in Sub-Saharan Africa, (1990), London: Routledge, p. 3; Teshome Mulat, 'Intra-African Trade' in James Pickett loc cit. at p. 150; Whalley John, (Ed), The Uruguay Round and Beyond, (1989), London: Macmillan.

Development (UNCTAD). Special demands for developing countries in this organisation included; the establishment of the New International Economic Order (NIEO) and the Charter of Economic Rights and Duties of States¹⁰. These documents aimed *inter alia*, at establishing general rules and conventions that would protect the interests of developing countries against TNCs and give their economic development special treatment.

Alongside the above mentioned negotiations, there are other North-South negotiations, like the ACP-EEC negotiations¹¹ and other bilateral negotiations between individual countries.

It is observed that the trend of developing countries in these negotiations has changed from confrontation, which dominated the 1970s, to co-operation since the 1980s. This change can be attributed to internal as well as external problems which seriously affected the economies of developing countries towards the 1980s. At the international level, developing countries lost support of the socialist countries in the UN debates¹². At national level, many developing countries were badly hit by economic problems. The latter can be attributed to the sudden rise in oil prices, problems of balance of payments, stagnation of economic growth, foreign debt and deterioration of terms of trade which were the result of recession and protectionism in developed countries. Being faced with these problems, developing countries had to revise their economic policies. Structural adjustments and "open - door" policies, based on co-operation were adopted.

Apart from the above problems, the world was faced with problems which threatened even the interests of developed countries. For example, the environmental problems¹³ which would result in the rapid exhaustion of natural resources of human heritage and human life. Co-operation between developing and developed countries was needed to solve them.

Thus, towards the end of 1980s a deal/compromise was reached between developed and developing countries. UN monetary institutions, particularly the IMF and the World Bank changed their policies towards developing countries. The aim was now to "help" them to become

¹⁰General Assembly Resolution Nos. 3201 (S-VI) & 3281 (XXIX), reproduced in (1974) , 13 I.L.M., at p.715;720 and (1975), 14 I.L.M., at p. 251 respectively. More discussion about these documents is provided in chapter five infra pp. 171 - 175.

¹¹Negotiations between ACP and EEC countries have culminated in the signing of the Lome IV Convention, reproduced in The Courier, No. 120, (1990). More discussion about this document is provided in chapter five infra pp. 176 - 178.

¹²Jerzy Makrazyic, Principles of the New International Economic Order, (1988), Boston: Martinus Nijhoff, at p. 70.

¹³Michael Manly & Willy Brandt, Global Challenge: From Crisis to Co-operation: Breaking the North-South Stalemate, (1985), London, Pan Books Ltd. pp.25 - 45; Brandt Willy, North-South: A Programme for Survival, (1982), London, Pan Books, pp. 64 - 77; Brandt Willy, Common Crisis: North-South Co-operation for World Recovery, (1983), London, Pan Books, pp. 21 - 38; Nyerere J. K, The Challenge to the South., (1990), Oxford, Oxford University Press.

self reliant by liberalising and privatising their economies, and hence, creating free market economies of free enterprise and free competition. Inter-regional and bilateral agreements and treaties were signed to the same effect. However, this compromise should be looked at from a new perspective, different from that envisaged before the NIEO. It is now based on co-operation (interdependence) and self-reliance, rather than confrontation¹⁴.

Since the change of outlook the number of TNCs investing in developing countries has been increasing¹⁵. But the twin concerns of self-reliance and co-operation have greater implications than envisaged. They imply conflicts between, on one hand, the national objectives of developing countries and, on the other, the global strategies of TNCs¹⁶. The question is whether and by what means a mutually advantageous relationship which encompasses both co-operation and self-reliance can be cultivated between TNCs and developing countries. Joint ventures between these parties are seen as an answer to this question.

2:1:2 Classification of Developing Countries.

Though flexible, the policies of developing countries towards transnational corporations are very diverse. They depend on each country's potential and the complexity of its resource endowment, level of economic activity, culture and general development strategy. On one hand, developing countries are faced with the growth of modern industrial sector: the emergence of indigenous private, state and mixed entrepreneurs with sharp demands for protection of national infant industries from foreign competition. On the other hand, developing countries need foreign technology, management skills, know-how and investment capital to be able to develop the local industrial base and penetrate the world market. The latter needs can be obtained from transnational corporations which themselves need to penetrate the local markets of developing countries, and get abundant supplies of cheap labour and raw materials without sacrificing their global strategies.

An attempt is made, at the risk of generalisation, to place developing countries in three main

¹⁴According to the UNCTAD report: 'It has indeed been acknowledged that interdependence is as inherent element of the NIEO as self-reliance. Thus, the realisation of the...NIEO does not mean autarchy, but co-operation. Its objective is that developing countries and developed countries should be equal partners in a new and more equitable design for the world economy...', UN. supra n. 8 at p. 18. (my own emphasis)

¹⁵In most cases in joint venture forms. See further Navetti Giorgia Babra, Joint Ventures in Developing Countries, (1991) D.Phil. Thesis: Cambridge University, pp. 1 - 2.

¹⁶UN supra n. 8 at p. 18; Navetti ibid. at p. 2; Barnett J. Richard and Muller Ronald, Global Reach: The Power of the Multinational Corporations, (1974), New York: Simon and Schuster, at pp. 123, 133 - 147; Burnell Peter J., Economic Nationalism in the Third World, (1986), Brighton Wheatsheaf., pp. 156 - 162; Ahiakpor C.W. James, Multinationals and Economic Development: An Integration of Competing Theories, (1990), London: Routledge. pp. 1 - 8.

groups, in order to assess their policies towards joint venture formation¹⁷. The first group represents those countries which have failed to attract transnational corporations, despite pursuing open-door policies for a long time. This is because of the small size of their markets and their limited natural resources. Most of these are small countries of the ACP region¹⁸ such as Fiji, Kiribati, Dominica, Haiti, Saint Lucia, Comoros, etc..

The second group represents countries which formerly excluded or limited the operations of transnational corporations. These include: China, Cuba, Egypt, Guinea, Nicaragua, The United Republic of Tanzania, Zambia and Vietnam. These countries have modified their policies significantly. State enterprises have been allowed to form joint ventures with transnational Corporations and the operations of private enterprises or privatisation of former state-owned enterprises have been permitted, albeit in joint venture forms. China in 1979, Cuba in 1982 and Ethiopia in 1983 enacted joint venture laws¹⁹. Other countries like The United Republic of Tanzania and Zambia have enacted investment laws which allow foreign investment in the form of joint ventures, apart from giving foreign investors enormous incentives to lure their investments into their countries²⁰.

The third group comprises of countries with market economies like those of Western developed countries. These have been the centre of attraction for transnational corporations' investments, but mainly in the form of subsidiaries. They include: Argentina, Brazil, India, Pakistan, The Republic of Korea, Mexico, Venezuela, Nigeria, Philippines, Kenya, Singapore and Malaysia²¹. Although the policies of these countries have not changed significantly, some regulations applicable to subsidiaries of transnational corporations have been established²². These regulations provide *inter*

¹⁷This categorisation is taken from, UN, Transnational Corporations in World Development: The Third Survey, (1983), UNCTC: New York, p. 56.

¹⁸Ibid., p. 56.

¹⁹Ibid. p. 56; Moser J. Michael, (Ed.), Foreign Investment and the Law in the Peoples Republic of China, (1987), Honkong: Oxford University Press, pp. 1 - 4 he traces the history of China's investment policy which culminated in the enactment of the China's Joint Venture Law in 1979; Tanzania Investment (Promotion and Protection) Act No. 3 of 1990; Eerso P., 'Tanzania's policy on Private Investment', 14 The African Rev., (1974), 61; Peter Chris, 'Foreign Investment in Tanzania: The Study of Legal Framework', Konstanz, Hartung-Gorre Verlag, (1989); Peter Chris, Private Investment in Tanzania: A Comment on the New Investment Code, (1991), Dar es Salaam, Frederick Ebert Stiftung; Kamuhanda, M.B., 'Zambia's Investment Act of 1986 in Perspective - Progress or Retrogression?', Proceeding of the First Annual Conference on Foreign Investment in Lusaka, 30th Jan. - 3rd Feb. 1989, p. 81.

²⁰Tanzanian Investment Act, ibid. part IV; UN (ECA), Investment Africa, (1983), No. 1, Dec., p. 3.

²¹UN supra n. 17, at p. 57.

²²Ibid. p. 57; Narendra K. Sabharwal, 'Issues Arising from Technology Transfer through Joint Ventures', in UN, Joint Ventures as a Channel for the Transfer of Technology, (1990), New York, at p. 69 he notes that in 1973 India enacted the Foreign Exchange Regulation Act which required all trading companies and manufacturing industries to reduce the foreign equity participation to 40% or less; Burnell supra n. 16 at pp.161 - 162 notes that Mexico in 1973 and Nigeria in 1972 and 1976 enacted Laws/Decrees with more or less same effects.; On Nigeria see further Beveridge C. Fiona, 'Taking Control of Foreign Investments: A Case

alia for the prohibition of foreign participation in specific areas, the control of take-overs, the prohibition of restrictive business practice, and transfer of technology. Some regulations have provided for the "dilution" of TNCs subsidiaries' control to include the participation of local entities through joint ventures. Several countries of this group have amended their laws since the 1970s to be more flexible and pragmatic and to accommodate such changes. For example, Argentina's laws of investment of 1973 were made more flexible in 1976²³. Since the 1975 Philippines has started to liberalise its policies culminating in an omnibus Investment Code of 1981²⁴, which allows joint ventures with TNCs. In 1977 Pakistan declared its guarantee and incentives for foreign investment. In 1989 Kenya passed the Investment Code which allowed the formation of joint ventures with transnational corporations²⁵.

2:2. MOTIVES FOR JOINT VENTURE FORMATION

2:2:1 Transnational Corporations.

Transnational corporations always initiate their businesses by exploiting domestic markets. However, sooner or later, due to domestic market financial constraints and expansion ambitions, they will start to look for markets or source of raw materials abroad²⁶. Initially, overseas expansion is done through export or import of goods by on-spot contracts. However, this exercise has its own limitations. It may be difficult to find importers and agents who will provide adequate market information, the type of service and customer liaison necessary for many technical products may not be available to the local exporter, especially in markets in developing countries. Policies of the importing governments, such as trade regulations and administrative barriers may be seen as producing risks for many TNCs. Thus, the selling and buying of products outside national boundaries involve different legal, cultural and political factors which interfere

Study of Indigenisation in Nigeria', 40 I.C.L.Q. (1991), pp. 303 - 333; Carson Jerker, 'Critique of a Joint Venture', in Ghai Yash, Lucham Robin and Synder Francis (Eds), The Political Economy of Law: A Third World Reader, (1989), Delhi: Oxford University Press, pp.474 - 483; See also Biestreker J. Thomas, "Transnational Corporations and the Neutralisation of Legislation", in Ghai et al, loc. cit. pp. 465 - 474.

²³ Burnell supra, n.16. p. 161; UN supra n. 17, at p. 57.

²⁴ Lilia R. Bantista, 'Joint Venture Agreements and Technology Transfer: The Philippine Experience', in UN supra n. 22 at p. 129.

²⁵ UN ibid. pp. 57 - 58.

²⁶ Rugman Alan, International Diversification and the Multinational Enterprise, (1979), Lexington: Lexington Books Ltd., Ch. 2 pp. 3 - 9; Ahiakpor James supra n. 16, p. 10; Buckley P. E, Multinational Companies, (1979), Bradford: MCB Publications, at p. 3; Vernon Raymond, Storm over Multinationals, (1977), London: The Macmillan Press, p.3; Poyenter A. Thomas, Multinational Enterprises and Government Intervention, (1985), London: Croom Helm, pp. 41 - 42; Hood Neil and Young Stephen, The Economics of Multinational Enterprises, (1979) London: Longman, pp. 6 - 7.

the on-spot market transactions and have to be taken into account²⁷.

More problems may be experienced when the trade is done in technical and intangible products such as technology and managerial skills. These can be "sold" through licensing, and management and consultancy agreements. These agreements like the exporting/importing agreements are not without costs. For example, in the licensing agreements the TNC is exposed to the risk of losing the market when the licensee does not perform to its expectations particularly in respect of the maintenance of quality and service standards. Management consultancy agreements may cause even greater problems because, unlike licensing agreements these agreements involve the TNC in the supervision, to a certain degree, of the business of the local company, with objectives which may conflict with those of the local company or its government.

However, the legal implications which arise from these transactions are worth of attention. Legally speaking, these transactions are regulated by general laws of contract. Thus, parties are left as independent enterprises, save for the commitments they promise to undertake under the contracts. However, as observed elsewhere²⁸, some of these arrangements pose legal issues which cannot be solved by contract law alone. For example, when the company from developing countries subjects its management to the TNC and therefore foregoes its control (at least according to the Berle and Means hypothesis), these arrangements inevitably alter, to some extent, the way the legally independent structure can realise the objectives for which it was established²⁹. The Board of Directors of the controlling enterprise (TNC) exercises a decisive influence over the Board of a dependent enterprise. Unless their arrangements are based on arms-length negotiations, in which case parties still maintain/retain their independence, they should be analysed as factors which influence changes in the structures of dependent corporations from developing countries.

Because of the precarious nature of these arrangements, it is likely that both parties will consider markets insecure and expensive to run³⁰. Governments of the importing companies are likely to interfere to protect the interests of the local companies. TNCs may also decide to participate in the ownership of the local companies in order to protect their interests. Eventually, the decision of the TNC to set up production facilities abroad is far from inevitable.

Other reasons which induce the TNC to involve itself in FDI in developing countries are of an economic nature. For example, due to the rapid technological development at home, the TNC

²⁷Hood and Young *ibid.* p. 7; Rugman *ibid.* p.3.

²⁸*Infra* p.38 - 40.

²⁹Mukoyogo *supra* n. 2, p. 116.

³⁰Ghai Yash, 'Management Contracts', in Ghai et al. *supra* n. 22. p. 391 - 392.

may no longer require a certain technology. This technology may still be required in developing countries. Establishing a production plant in these countries may be cheaper than exporting already finished goods. Sometimes the nature of the technology, because of its sophistication, complexity and handling of the produced good, may force the TNC to establish plants producing these goods abroad³¹.

Therefore, the decision to invest in developing countries is reached by the TNC when total costs of producing abroad (including control costs) are below the costs of exporting from the parent company and selling in the open markets of developing countries. These costs may be due to economic, political, legal or social factors.

FDI inevitably involves ownership by the TNC (in whole or in part) and management/control of the foreign operation in the host countries (developing countries). The most clear-cut and safe means of FDI is by establishing a wholly-owned subsidiary. By and large, the subsidiary is supposed to be an "independent" enterprise when operating in the host countries. In other words, it is supposed to be controlled only by its parent TNC. This independence however, is subject to socio-economic conditions of the host countries in which these subsidiaries operate. For example, the host government may impose discriminatory treatments on the 'foreign' subsidiary. Again, lack of local identity may deny it a good deal of business, such as customers and local markets. As such, the subsidiaries established may not be fully independent. When these factors are considered, the TNCs may decide to establish joint venture companies with local partners, as the second best alternative.

(I) Reasons for the joint venture establishment by the Transnational Corporation.

Studies on why TNCs invest in developing countries show that joint venture companies, not wholly-owned subsidiaries, are the dominant form of business organisations³². Different reasons have been suggested for this.

One of the major reasons is the reduction of high financial risks that are anticipated in developing countries when the business project fails. According to Root³³ there are two types of risk;

³¹Vernon supra n.26 at p. 36 gives an example of Japanese TNCs which produce electronic equipment.

³²Navetti, supra n. 15, p. 1; Beamish W. Paul, Multinational Joint Ventures in Developing Countries, (1988), New York: Routledge, p. 1; Vampel James and Cuhan Joan, The World's Multinational Enterprises, (1978), Boston: Massachusetts, pp. 1 - 10; Friedman Wolfgang and Kalmanoff George, International Business Ventures, (1961), New York: Columbia University Press, p.29; Wallace Day Cynthia, Legal Control of the Multinational Enterprise, (1982), The Hague: Martinus Nijhoff, pp. 75 - 78; Dunning H. John Multinational Enterprises and Global Economy, (1993), New York: Addison-Wesley, p. 237.

³³Root Franklin, 'Some Taxonomies of International Co-operative Arrangements', in Contractor Farouk and

fiduciary risk and environmental risk. Fiduciary risk is the probability that enterprises from developing countries will fail to carry out their responsibilities when dealing with TNCs in open markets and that they may use the benefits of co-operation for their individual gains outside the contract. This can be reduced when a joint venture structure is created to enable TNCs to participate actively in the marketing of their products or extracting raw materials for their home industries. Environmental risk includes; political, economic and competitive factors likely to affect the size of a given participant's (TNC) assets. The risk is reduced when ownership of the same structure is shared, especially if one of the parties can influence the likelihood of a particular occurrence. Hargett and Morris³⁴ argue that risk sharing implies reward sharing. Companies are ready to share risks when they are assured that they will share the rewards obtained from the venture too. In other words, the fact that the rewards of the venture are likely not to be shared equally or proportionally creates even a bigger risk which has to be solved through management sharing and joint monitoring by the parties³⁵.

Another main purpose of the use of joint venture method is to obtain access to marketing skills and market networks in developing countries³⁶. The local markets of developing countries are growing significantly and becoming attractive to TNCs. The problem is the TNC's lack of adequate knowledge of these markets, their accessibility and distribution networks. Such information can be obtained from partners from developing countries. Parallel with this factor are other subsequent reasons for using a joint venture as the source of acquiring markets for cheap raw materials and cheap labour.

Another reason is the TNCs' need for the developing countries partners' attributes or assets. According to Beamish³⁷, assets include such things as cash or patents, while attributes may be manufacturing assets which make a firm desirable to manufacture joint venture goods. TNCs can only benefit from immovable assets that are owned by local companies, given the latter's relatively low ability to own other property/assets such as technology, cash and machinery. The immovable property includes rights over land and its natural resources³⁸.

Lorange Peter (Eds) Co-operative Strategies in International Business, (1988), Lexington: Lexington Books, p. 74.

³⁴Hargett Michael and Morris Deigan, 'The Trends in International Collaborative Agreements', in Contractor and Lorange *ibid.*, p. 100.

³⁵Thus, fiduciary risk may also exist in the joint venture mechanism, and management control alone may not be enough to reduce it. In the fourth chapter, *infra* we shall make a case for the extension of fiduciary duties to cover all the parties to the joint venture company.

³⁶Franko Laurence, Joint Venture Survival in Multinational Corporations, (1971), New York: Praeger, p. 26; Buckley J. Peter and Cusson Mark, 'A Theory of Co-operation in International Business', in Contractor and Lorange *supra* n. 33, p.405; Killing *supra* n.3, p. 6.

³⁷*Supra* n. 32, p. 11.

³⁸Friedman and Kalmanoff *supra* n.32, p. 2; Stedman Graham and Jones Janet, Shareholders Agreements, (1990), London: Longman, p. 205.

Perhaps the major reason for TNCs adopting a joint venture form is to overcome host government mandated or imposed investment barriers and other factors caused by the local government suasion or legislation³⁹. Government suasion include incentives which are provided by developing countries' Investment Laws, such as tax exemptions and the lifting of non-tariff restrictions for TNCs willing to invest in joint venture forms⁴⁰. Although some laws may be seen as measures by local governments to intervene in the business of TNCs and therefore less acceptable⁴¹, they are tolerated by TNCs because joint ventures can serve the need of a TNC to respond to local government orders and policies without necessarily affecting its global strategies. Further, the acceptance of the local partner helps to give to the TNC a local identity and improve its image in the eyes of local policy makers. Beamish⁴² observes that the majority of joint ventures in developing countries (i.e. 57%) are formed due to the host government's suasion or legislation. His findings are supported by Gullander⁴³ who says that the reasons why TNCs would accept joint ventures in developing countries are more political than economic.

The most mentioned but least discussed reason is the fact that joint ventures serve to block or reduce competition between TNCs and local companies or other potential entrants in the local markets. According to Peter Gabriel⁴⁴ this is the main reason for the joint venture formation by TNCs in developing countries. TNCs want to remove competition or co-ordinate operations between their subsidiaries, located in more than one country. Through this, the economies of host countries are tied to TNCs' global market strategies.

(II) Some weaknesses in the reasons.

The above mentioned reasons can be categorised into *specific and non-specific reasons*⁴⁵. However, this categorisation may be difficult to make, because; like joint ventures themselves, their motives come in many different shapes which makes it difficult to pin them down in simple

³⁹Beamish Paul supra n. 32, p. 11; Contractor and Lorange supra n. 33, p. 9; Gabriel P. Peter, International Transfer of Corporate Skills: Management and Contracts in Less Developed Countries, (1967), Boston: Harvard University Press, p. 91; Poynter A. Thomas, Multinational Enterprises and the Government Intervention, (1985), London: Croom Helm, p. 2; Herzfeld Edgar, Joint Ventures, (1983) Bristol: Jordan & Sons, at p. 25 refers to this as "overcoming national prejudices".

⁴⁰Friedman and Kalmanoff supra n. 32, p. 224.

⁴¹Poynter Thomas supra n. 39, pp. 13-15, 203; Vernon supra n. 26, p. 35; Killing supra n. 3, p. 71.

⁴²Supra n. 39, p. 11.

⁴³Gullander Staffan, 6 Columbia Journal of World Business, (1976) pp. 1-2.

⁴⁴Supra n. 39, pp. 91 - 94.

⁴⁵This categorisation is adopted from Friedman and Kalmanoff supra n. 32, pp. 125 - 129. However, there may be several ways of categorising these reasons. For example, Downes Anthony and Julian Elison, The Legal Control of Mergers in the European Communities, (1991), London: Blackstone Press Ltd., at p. 138, categorise them as core and ancillary.

categories. A motive which is specific or core to one enterprise (TNC) may be non-specific to the other, depending on its strategies and objects. Nevertheless, a critical analysis of these reasons shows that a general categorisation is possible.

Specific reasons mean those without which the TNC is unable to invest in a particular country. In other words, those reasons which make the contribution of the local company an indispensable part of the venture. According to Friedman and Kalmanoff⁴⁶ these include the local capital to be contributed by the local partner, immovable assets like land and natural resources, and machinery⁴⁷.

Thus, other reasons like obtaining access to the local markets and their distribution networks, or becoming familiar with the local social, cultural and political conditions, are non-specific and ancillary. What makes them so is the fact that they are temporal in nature when compared to the main objectives. They can be tolerated as far as the core reasons are fulfilled⁴⁸. Vernon⁴⁹ says:

'Many networks [of TNCs] have been prepared to accept local partners in the subsidiaries....In such cases, effective control can be maintained through the provision of capital...the parent may be prepared to accept the risk of an occasional squabble with local partners over the remaining critical questions....'

As long as the core reasons are not part of the reasons for joint venture establishment on the side of the TNC, the TNC is ready to accept the participation of the local company. The "joint venture" created is dependent on a flow of money or technology from the TNC, or on the use of its name. The TNC's control therefore remains intact. Vernon continues to observe that:

'The prevalence of these so called joint ventures seems to obscure the real boundaries of any Multinational network. But various closer studies indicate that joint ventures are generally linked to the Multinational networks according to a few well-defined patterns⁵⁰.

This therefore means that "jointness" *per se* does not indicate the existence of the joint venture⁵¹. This oversight has been one of the major weaknesses in the reasons for joint venture formation by TNCs. When "joint ventures" are established with local distributors to capture the local markets and avoid tariffs and other regulations, they are not true or genuine joint ventures because:

'In a situation like this the joint venture's most important role is as the mechanism which allows companies with conflicting objectives to work together. It is not a profit maximising firm in the normal sense, nor does it contain a

⁴⁶Ibid. p. 129.

⁴⁷Beamish *supra* n. 39, pp. 11 - 12.

⁴⁸Franko Laurence *supra* n. 36, p. 141.

⁴⁹*Supra* n. 26, p. 35.

⁵⁰Ibid. p. 35.

⁵¹Friedman and Kalmanoff *supra* n. 32, p. 126.

group of executives committed to a *common goal*⁵²,

It is argued later that it is the complementarity or the interdependence of the specific or core motives which result into the creation of a true joint venture⁵³. Otherwise when the core is empty it is more likely that conflict of interests within the venture will arise. Or one party will exert control over the other through outside means and make it more dependent. The outside means include licensing, management and consultancy agreements which TNCs conclude with their joint ventures. When discussing this issue Killing noted that:

"There are a variety of legal documents which invariably accompany the creation of the joint venture....These documents deal directly with control in its most direct form....However, there is always a series of agreements between the joint venture and the foreign partner....In a more subtle way, each of these agreements confers some degree of control on the foreign partner apart from giving it royalty fees and transfer prices⁵⁴."

If carefully studied, the reasons which make TNCs accept local partners are not found to be of equal importance. Some reasons are temporary, some permanent. Those which are temporary need temporary structures. When one considers the fact that many developing countries have no technical and capital attributes to offer to TNCs for permanent structures, all the above reasons can be summed up as observed by Franko⁵⁵, that joint ventures are established as "an offset to nationalism or as a tactic in foreign market entry". However, this depends on the motives of partners from developing countries.

2:2:2 Motives for Joint venture formation on the side of the local company.

The motives of transnational corporations for the establishment of joint venture companies in developing countries have to be counter-balanced with the motives of the host country. It aims to integrate the joint venture company in its national economy. Although both parties may be aiming at maximising corporate profits, it does not necessarily follow that national economic objectives will be achieved.⁵⁶ TNCs have to consider not only their objectives, but also the objectives of their partners and, usually the national objectives of the host country. As they are likely to affect the formation and operation of the joint venture. With the exception of a few instances, the national goals for the creation of joint ventures with TNCs are reflected in different goals of various local companies. Since these goals can be more fully realised in companies in which the government has

⁵²Killing supra n. 3 at p. 71. (my own emphasis).

⁵³True joint ventures here refer to joint ventures which are formed when core objectives of the parties are complementary. This is also noted by Contractor and Lorange supra n. 33 at pp. 9 & 19.

⁵⁴Supra n. 3, pp. 24 - 25; More discussion on these agreements is provided in chapter six infra pp. 234 - 242.

⁵⁵Supra n. 36, p. 4.

⁵⁶Krasner D. Stephen, Structural Conflicts: The Third World Against Global Liberalism, (1985), Berkeley: University of California Press, pp. 177ff.

some stake, our main point of reference will be joint ventures created between TNCs and local publicly or state-owned enterprises.

(I) Reasons for joint venture establishment by Developing Countries.

Companies from developing countries establish joint ventures with TNCs in order to acquire technology, know-how and managerial skills from TNCs. The fact that many enterprises in developing countries cannot reach their targeted objectives because of lack of adequate technology and managerial skills cannot be over-emphasised⁵⁷. Joint venture companies are considered as a good mechanism through which these enterprises can be able to acquire TNCs' technology without sacrificing ownership of the whole enterprise to the TNC. According to Dymsha⁵⁸, host countries expect that through joint ventures local enterprises will enter into profitable manufacturing operations with prestigious TNCs to obtain essential technology, business know-how and trade marks. This will in turn contribute to the developing countries' industrialisation and economic development, increase national income and employment, and possibly contribute to the development of the backward areas of the country.

Another reason is the desire of local enterprises to get access to foreign markets and distribution networks. It is indisputable that developing countries have faced problems in entering international markets. This situation is complicated by some international barriers⁵⁹. The creation of joint ventures with TNCs, which have already entered the markets or are the potential entrants, is seen as the only way out. It is assumed that when the international markets are open, local companies will be able to sell through joint ventures their manufactured/produced materials and will be able to buy from the international markets the raw materials they require at reasonable and concessionary prices.

Companies from developing countries also use joint ventures in order to get access to foreign capital. The fact that companies in developing countries lack investment and working capital can not be over-stressed. The increase in the magnitude of foreign debts in these countries has caused financial institutions to stop or reduce the amount lent to these countries. Some institutions have insisted on the formation of joint ventures with TNCs as a condition of granting loans. According

⁵⁷UN (UNCTAD), Major Issues Arising from Transfer of Technology To Developing Countries (1975), New York: UN Press, pp. 405 - 406.

⁵⁸Dymsha A. William, 'Success and Failures of Joint Ventures in Developing Countries: Lessons from Experience', in Contractor Farouk and Lorange Peter supra n. 33, pp. 404 - 406.

⁵⁹Krasner supra n. 56, p. 177; Claret Ramont and Whalley John, 'Trade-restricting Effects of Exchange Rate Regimes: Implications for Developed-Developing Countries Trade Negotiations', in Whalley John (Ed), Developing Countries and the Global Trading System, (1989), London: Macmillan, pp. 66 - 85.

to Ghai⁶⁰ this is the policy of the World Bank whose terms routinely provide for the immediate repayment of the loan if the recipient country terminates the joint venture agreement. However, this may be seen as an advantage to the host/local company because it reduces the risk of paying the whole debt in case the joint venture fails. Thus, like the TNC, developing countries regard joint ventures as a risk sharing device.

Perhaps the main and most important reason for the preference of developing countries for the joint venture form over subsidiaries of TNCs, stems from their need to develop the national industrial base. In a sense, it is a struggle to ensure that indigenous people own major enterprises in their countries⁶¹. This explains why in many developing countries joint ventures have been formed due to the government suasion or legislation. Government suasion is adopted when the establishment of the TNC's subsidiary is necessary to the development of the economies of these countries and when TNCs insist on establishing wholly-owned subsidiaries. Companies (TNCs) which survived nationalisation of late 1960s and early 1970s in most developing countries, were transformed into joint ventures with the participation of local companies because local governments still needed them. The desire to retain the enterprise in the hands of indigenous people therefore, affects the choice of the joint venture structure to be formed, especially during the process of privatising state-owned enterprises⁶².

In contrast with joint ventures formed due to government suasion are what Poynter⁶³ calls "forced joint ventures". These are formed where local governments, through legislation, "force" TNCs to accept joint ownership with local companies. As with suasion, the motive behind the compulsion is the desire of local governments to retain ownership in the hands of the indigenous people. A widely discussed example of this is obtained from Nigeria which since 1972 has been enacting laws to "indigenize" subsidiaries of TNCs. India also took the same steps of "diluting" the ownership of the subsidiaries. Some other countries like Mexico, Brazil and Southern Korea have also followed the suit⁶⁴.

(II) Some weaknesses in the reasons.

Like the analysis of the reasons for the joint venture formation by TNCs, the analysis of the reasons by companies from developing countries pose a number of problems. This is because

⁶⁰Supra n. 22, pp. 391-392.

⁶¹Dymsza supra n. 58, p. 20.

⁶²As will be discussed below, many joint ventures in developing countries after 1980s, have been formed because of local governments efforts to retain former state owned enterprises in local ownership, after their privatisation.

⁶³Supra n. 39, p. 20.

⁶⁴See our discussion supra pp. 8 - 9.

developing countries' goals and policies differ and depend on a particular group of people in power⁶⁵. However, as indicated above, common problems of developing countries include: lack of modern technology, capital and foreign market networks to be able to establish manufacturing industries on their own and be able to export independently in the international markets. Therefore, joint ventures are seen, on one hand, as the struggle by developing countries to obtain these essentials, and, on the other, as the struggle to build an indigenous industrial base. In order to analyse these motives, it is convenient to divide them between the period before the 1980s and the period after.

(a) Period before 1980s.

Generally, this period was characterised by the regulation of entrance and business of TNCs. The degree of regulation differs from one country to another and from those countries which had a planned economy to those which had a mixed economy⁶⁶.

(i) For the countries which had planned economy, this period is characterised by laws and regulations which disallowed foreign direct investments; the nationalisation of foreign subsidiaries and the establishment of the state-owned enterprises, based on import substitution⁶⁷. Having tested the bitterness of colonialism, these countries had determined to build an indigenous industrial base, as Professor Lewis⁶⁸ described the situation:

'At present most of the less developed countries are in a state of reaction against the 19th century imperialism. They have acquired a distaste for foreign capital and foreign administration, and they are more anxious to protect themselves from further exploitation than to take advantages of current opportunities'.

One major weakness of these countries' decisions was an attempt to create independent enterprises through isolation. The struggle could not eliminate interdependence or rather dependence on TNCs where these countries did not have resources or skills available only from TNCs. Because of restrictive laws against FDI, TNCs had to "invest" through contracts. Yash Ghai argues that after the nationalisation and creation of state-owned enterprises, TNCs lost control of their former companies or partner companies through increasingly legal regulations. But the subsequent contracting proved that TNCs 'lost ownership but continued to control the

⁶⁵Vernon supra n. 26, pp. 139 - 140.

⁶⁶See supra discussion, pp. 7 - 9.

⁶⁷For example, Tanzania in 1967 nationalised most of privately-owned enterprises, most of whom were former subsidiaries of TNCs. See Ghai Yash, 'Law and Public Enterprises' in Ghai et al supra n. 22, pp. 549 - 558; Katende, The Law of Business Organisations in East Africa, (1976) Nairobi: East African Press, p. 1 - 7; Tem P. 'Nationalisation in Tanzania', IV East African Law Journal, (1967), 35; Mwapachu Juma, Management of Public Enterprises in Developing Countries, New Delhi: Oxford & IBH Publishing Co., pp. 1 - 12.

⁶⁸Lewis A., The Theory of Economic Growth, (1976), London: Maxwell & Sons, p. 25.

operations of the enterprises under an agreement: *a contract became the basis of control*⁶⁹. This proves that 100% legal ownership of an enterprise, does not necessarily guarantee effective control of its operations.

The proliferation of contracts by TNCs was partially due to the unavailability of local technology and know-how. Indeed it has been observed that indigenous technology is necessary if the enterprises from developing countries want to acquire foreign technology which is appropriate to their needs. 'It is not an alternative to the transfer but a necessary condition for it'⁷⁰. An amount of local technology is required first and foremost to put the recipient on the position of acquiring the technology, and, secondly, to allow it to determine the value of the technology to be acquired⁷¹.

Thus, because of lack of local technical know-how, TNCs had to manage the technology they "sold" to the local companies through management and consultancy agreements⁷². Studies which have been conducted on some of these agreements show that they were "blood sucking contracts"⁷³. That they did not benefit both the TNC and local companies but only the TNC. Through these contract TNCs managed to "package" many conditionalities to the local companies to the extent of taking some degree of ownership in local companies. Local governments accepted the move provided they remained the majority shareholders⁷⁴. And in the areas in which local governments lacked the required technology, TNCs were now allowed to establish their subsidiaries provided they accepted a limited degree of control and regulation by the government.

This shows that both developing countries and TNCs were interdependent and needed each other. The problem was the failure to adopt an appropriate structure which could enable both sides to benefit. Further, it proved to developing countries that in the state of interdependence in which they find themselves, isolation or establishing an enterprise based on legal ownership alone may not be an appropriate solution.

(ii) In the other main group of developing countries, subsidiaries of TNCs were allowed to operate. As with the first group, public enterprises in these countries also entered different agreements on transfer of technology with TNCs⁷⁵. However, their arrangements were

⁶⁹Ghai supra n. 30, p.389. (emphasis on the original).

⁷⁰UN, supra n. 17, p. 67; Navetti supra n. 15, pp. 3 - 4.

⁷¹UN (UNCTAD) supra n. 57, pp. 1 - 12.

⁷²Gabriel supra n 39. provides a detailed analysis of these agreements.

⁷³Sinare Mwanaidi, The Legal and Juridical Framework Governing the Importation of Technology into Tanzania: An Examination of the Effectiveness of Contractual Agreements as Technology Transfer Mechanisms, (1981) Diss.: University of Dar es Salaam.

⁷⁴Ghai supra n. 30, p.389; Mukoyogo supra n. 2, pp. 114 - 116.

⁷⁵Gabriel supra n. 39, gives detailed discussion about these agreements, pp. 11 - 12.

contractual joint ventures rather than mere contracts, because local companies managed to negotiate reciprocal performances by TNCs, given the fact that they had some degree of local technology and know-how. To some extent, their bargaining power was increased by the enactment of different laws to regulate the mode of formation and execution of these agreements⁷⁶.

The principal aim of struggling to build an indigenous economic base caused some countries in this group to enact laws to "force" the establishment of joint venture companies by the "dilution" of TNCs' subsidiaries⁷⁷. The dilution however had little effect when parties to the forced joint ventures were not in the situation that required one. That is, when there was no interdependence between them. As such, the joint ventures and therefore, the laws were untimely. Poynter⁷⁸ gives an example of countries like Mexico, Brazil, Spain, Nigeria and India among the countries which attempted the dilution exercise. He later observes that when they are untimely 'forced joint ventures sometimes help the subsidiaries [of TNCs] to get superior local knowledge and contracts to obtain cost reduction in surrounding government regulations'. This means that untimely forced joint ventures may be to the disadvantage of local companies. But sometimes they are also to the disadvantage of the TNC and they may disrupt their production, when the TNC is unable to tolerate the new local partner⁷⁹. At worst they are to the disadvantage of both parties⁸⁰. Studies made by Thomas Biersteker⁸¹ and Fiona Beveredge⁸² on the Nigeria indigenization programme since 1970s, where different laws were enacted to transform subsidiaries of TNCs into joint ventures by selling at least 40% of their shares to local companies prove this observation. After analysing the laws of indigenization and the process of their implementation, Beveredge concludes that the issue of indigenization could not succeed because of the misconception of ownership and control:

Besides not constituting a majority holding, 40% share does not necessarily guarantee 40% control or even 40% of the profits⁸³.

This view is shared by Biersteker who analyses different methods used by TNCs to evade the laws

⁷⁶Gabriel *ibid.* at p. 11 gives examples of countries of Latin America and India; UN (UNCTAD) *supra* n. 57, at page 23 gives examples of different countries which enacted laws for regulation of technology transfer in their countries, these countries include: Argentina (1971), Chile (1960), Columbia (1967), India (1948), and The Republic of Korea (1966).

⁷⁷Examples of these countries are provided *supra* p. 8 - 9, n. 22.

⁷⁸*Supra* n. 39, p. 19.

⁷⁹Refer to studies made by Fiona and Biersteker *supra* n. 22.

⁸⁰This is because production is based on individual gains and mutual suspicion rather than co-operation, the behaviour which may affect efficiency within the company, see Poynter *supra* n. 39, p. 21.

⁸¹*Supra* n. 22, pp. 465 - 474.

⁸²*Supra* n. 22, pp. 302 - 333.

⁸³*Ibid.* p. 331.

and concludes: 'As a result the move has merely encouraged local investors to invest in "foreign" companies rather than the "local" ones, thus providing a ready source of the venture capital to the foreign enterprise and making the local business community *more dependent* on the foreign enterprise than ever'⁸⁴.

The above weaknesses in the conception of joint venture establishment, show that state intervention or force alone is not equivalent to an increase in the effectiveness of the state's actions. This is because sharing equity or mere joint ownership do not necessarily mean that control is shared. And perhaps the criterion of 50-50 share is not necessarily the sole indication of the existence of the joint venture. Poynter says that for the "desirable" forced joint venture to confer benefits on both parties, 'the domestic interventionist must be aware of the TNC subsidiary's business environments and must exercise control - and the TNC must allow control - over those areas in which the local partners can assist'⁸⁵. Surely this implies more than ownership of the majority or minority of equity. It implies an understanding of each party's objectives. It also implies a complementarity of goals which is reflected in the degree of interdependence between parties and enhanced through the bargaining power of each party. It is argued later in this study, that this and not the number of shares each party owns is the basis for the existence of any joint venture⁸⁶.

(b) Period after 1980s.

This period was characterised by political and economic changes in most developing countries. More significant were the movements towards trade liberalisation and privatisation of public enterprises. The 1970-1980s economic crises rendered public enterprises almost economically impotent. The economies of planned economy countries were hit hardest. However, in countries with mixed economies the public sector was not in good economic shape either⁸⁷. Despite differences in the level of failures of the public sector in these two groups of developing countries, one common concern was clear: that public enterprises in these countries were making losses and that they had to be restructured. Developing countries were advised by different international

⁸⁴Supra n.81, pp. 472 - 473. (my own emphasis)

⁸⁵Supra n. 39., p. 20.

⁸⁶Infra pp.28 - 31.

⁸⁷Some literature on privatisation such as Ramanadham V. V "Privatisation in Developing Countries: Introduction", in Ramanadham V.V (Ed.), Privatisation in Developing Countries, (1989), London: Routledge; Cook and Kirkpatrick Colin (Eds.), Privatisation in Less Developed Countries, (1988) New York: Wheatsheaf; Ramesh Adhikari and Colin Kirkpatrick, ""Public Enterprises in Less Developed Countries: An Empirical Review", in Heath John (Ed.), Public Enterprises at the Cross Roads, (1990), London: Routledge, show that countries like Pakistan, India, Argentina, Brazil, Nigeria, Mexico and Malaysia, to mention but a few, had public enterprises which had to be privatised.

financial organisations⁸⁸ and some developed countries to privatise their public enterprises as the best way of restructuring them. One method of privatisation, which may be favoured by many developing countries, is the creation of joint ventures between TNCs and local public enterprises. Thus, the core reasons for the formation of joint ventures have been supplanted by privatisation. However, the principal aim of struggling to develop an indigenous industrial base still exists and survives in joint ventures that are created under the banner of privatisation. An analysis of reasons for the establishment of joint ventures in developing countries would not be complete without a short analysis of the concept of privatisation.

(i) Joint Ventures and Privatisation.

Privatisation has become a philosophy as well as a catch phrase which covers an immense range of policies in developing countries, if not throughout the whole world⁸⁹. It touches both political and economic spheres. The number of studies on privatisation and its implications for developing countries has grown and cannot be analysed in detail here⁹⁰. This part only attempts briefly to analyse privatisation as far as joint ventures are concerned. It concentrates on the legal implications for joint ventures⁹¹.

Privatisation has different, though related, meanings. In its strict sense, it may mean transferring the ownership of public enterprises to private hands, the process which is popularly known as denationalisation or divestiture as opposed to nationalisation or centralisation. However, privatisation may be construed generally to include the process of trade/economic liberalisation and deregulation. In other words, it means adopting an open door policy by allowing enterprises to operate under market forces⁹². Both senses concern law but from different perspectives. The first sense has something to do with the legal forms or structures of business organisations and their ownership. The second deals with negotiations between and among the parties to these structures and their subsequent policing/regulation by the state. However, both senses are based

⁸⁸For example, Cook and Kirkpatrick *ibid.* at pp. 25 - 30 mention the World Bank, IMF and USAID that have started supporting privatisation programmes in Africa; Brett, E.A, 'States, Markets and Private Power: The Problems and Possibilities', in Cook and Krikpatrick *supra* n. 87, p. 54; Heald David, 'The Relevance of UK Privatisation on LDCs', in Cook et al. *loc. cit.* pp. 94 - 95, mentions that privatisation in LDCs has come because of loss in public enterprises, but also because of conditionalities by IMF, World Bank and USAID.

⁸⁹Ramanadham *supra* n.87, pp. 1 - 6; Price Catherine, Privatisation in Malaysia, (1988), University of Leicester: Dept. of Economics, Discussion paper No. 94.

⁹⁰See for example, studies cited *supra* n. 87.

⁹¹Gower L. B.C, Gower's Principles of Modern Company Law, (1992), (5th edn), London: Sweet and Maxwell, pp. 76 - 78 discusses some of the legal implications of privatisation in company law; Prosser Tony, 'Privatising Nationalised Industries: Constitutional Issues and New Legal Techniques', 50M. L. Rev. (1987), 16; More legal implication of privatisation, especially as far as the formation of joint venture companies are concerned will be discussed *infra* in chapter four.

⁹²Ramanadham *supra* n. 87, p. 4.

on the classical principles of freedom of contract, free competition and free enterprise. The two senses may be analysed separately under Ownership measures and, Organisational or Operational measures, respectively.

(a) Ownership Measures of Privatisation.

These are measures to transfer the ownership of public enterprises from "public" to "private" hands. Among the measures that are taken to effect the transfer are:

(i) Total denationalisation or divestiture.

This is achieved by selling government equities to individual people or companies. In cases when equities are to be sold to individuals the management is given a first priority⁹³, through the process known as management buy-outs. When equities are sold to another corporation, the process may be known as a take-over. In this process two or more corporations may join together to buy the enterprise, in which case a joint venture company may be formed.

(ii) Partial denationalisation or Partial divestiture.

This is the process where a proportion of the public enterprise's equity capital is sold to individuals or to other corporations. In this process a joint venture company may be created between the government and the party(s) who bought equities. The joint venture company formed is regarded as a "private" company because the shares owned by the government do not give it power of control. They may give it control only in some circumstances specified in the joint venture agreement. In this case the share owned by the government may be a "special" or "golden" share⁹⁴.

Partial divestiture may also be effected through the establishment of a new joint venture company. State-owned partners may contribute a part of their assets and activities or those of their subsidiaries, while TNCs may contribute capital, technology and/or managerial skills.

(iii) Liquidation or sale of assets.

This is regarded as the last resort of the divestiture process. The assets of the public enterprise are sold to private individuals or corporations, rather than leaving the public corporation to go on making losses. In other words, the company is regarded as bankrupt and is subjected to

⁹³But this is not necessarily so in countries where stock markets are developed. In these countries the enterprise may be "floated", in the sense that its assets are valued and their share value are offered to the public. See Ramanadham Ibid. at p. 6.

⁹⁴For the meaning of a special share see our discussion *infra* p. 25.

liquidation in a process akin to the liquidation of bankrupt private companies. The proceeds may be used to recover some of the loss caused by the defunct public enterprise, or to invest in a new joint venture with TNCs.

Three interrelated observations can be made on the above different ways of privatising public enterprises. First, that since most individuals and private companies in developing countries do not have enough capital to buy equities, and since stock markets in these countries are still under-developed, TNCs are in a good bargaining position to buy those equities. From this analysis therefore, a subtle meaning of privatisation, special to developing countries, arises: that denationalisation means more than changing the ownership of publicly-owned companies. It may include changing the nationality of the owners of the newly-privatised enterprises from local to foreign hands, creating "foreign corporations". This new meaning of privatisation affects the decision by developing countries whether to privatise totally or partially. Second, it is likely that the decision whether to denationalise totally or partially will be determined mainly on political rather than economic or commercial grounds. Given the principal aim of developing countries to create a local industrial base, the joint venture option may be preferred to total divestiture⁹⁵. Third, in so far as the foreign investors (TNCs) are concerned, there is a clear preference for the joint venture option with the local government. It is argued that TNCs think that privatisation through joint ventures in developing countries would give them a "local face" and allow them (TNCs) to secure the necessary protection from local governments⁹⁶. Further, given the fact that most of the enterprises being privatised in developing countries are those which have been making losses, TNCs are likely to prefer joint ventures to total take-overs, because of the fear of "taking over" liabilities of the defunct enterprises.

The implications of diluting the ownership of public enterprises to form joint ventures as one of the measures of privatisation are analysed elsewhere⁹⁷. Suffice it to say here that when a decision to share the ownership of public corporations is reached, the reasons for establishing joint ventures re-emerge. The question to be addressed is whether the joint ventures that are established will be able to fulfil those goals, and whether the joint venture company is the most suitable form. These issues may be answered by analysing other measures of privatisation.

⁹⁵This view is also shared by Ramanadham *supra* n. 87, p. 30; Cook and Kirkpatrick *supra* n. 87, p. 3. In fact most policies of developing countries on privatisation express the same view. Navetti *supra* n. 15, pp. 1 - 3, uses the examples of Cameron, Gabon and Thailand to prove this finding.

⁹⁶According to the views of Ramanadham *ibid.* pp. 46 - 47 these are the views of investors (TNCs) in Ivory Coast, Kenya, Ghana and Morocco.

⁹⁷*Infra* pp. 37 - 39.

(b) Organisational and Operational measures.

Organisational and operational measures are widely grouped under the process of deregulation and trade liberalisation. The general aim of these measures is to change market structures and the competitiveness of both types of enterprises (i.e. the denationalised and the "nationalised" ones), by reducing their legal monopoly rights and restricting government interference in their business⁹⁸.

To the denationalised enterprises, the reason for these measures is clear. Since their ownership has been made "private", the government (law) should not interfere with their activities. Even in the case where the government retains a degree of ownership in the form of joint venture, its powers to interfere with the activities of the joint venture should be specified. One way of achieving this is by giving the government a special or golden share. A golden share is one which restricts the government's participation in the decision making of the company except on specified matters⁹⁹. Specified matters include change of the joint venture's structure and ownership, and voting rights in deciding on the voluntary winding up of the joint venture company. However, the "veto" power of the golden share can only be exercised on grounds of public interests¹⁰⁰.

In the case of enterprises that remain public, organisational and operational measures aim at "breathing" into them a private life. This may be done by changing their monopolistic (holding) structures¹⁰¹; introducing new management; leasing the enterprises to private companies; encouraging efficiency in the management of the enterprises through incentives or rewards, targets for production; or restricting government subsidies¹⁰². Another method is to "contract out" those services provided by the public enterprise which make it inefficient in commercial terms.

(ii) Justification for privatisation.

Privatisation is always justified in economic terms, namely that it increases efficiency through competition. However, it has far reaching political and legal implications which may become clear with time. One question which may be of interest to answer is why policies have now moved towards privatisation as opposed to nationalisation and the development of the public sector which was previously considered to be the appropriate tool for achieving important objectives?

⁹⁸Irice supra n. 89, p.2.

⁹⁹Ramanadham supra n. 87, p. 22. Of course the same share may be used to retain or enhance government control on the pretext of protecting public interests, see Gower supra n. 91, p 77; See also Cosmo Graham and Tony Prosser, "Golden Shares: Industrial Policy by Stealth?", Public Law, [1988], 413..

¹⁰⁰Ibid. p. 22; Gower supra n. 91, pp. 76 - 78.

¹⁰¹Ramanadham supra n. 87, pp. 6 - 11.

¹⁰²Ibid. pp. 9 - 11.

Although this study does not attempt to provide an answer, a legal analysis of the rationale for the establishment of public enterprises in developing countries can shed some light on important issues which may affect joint ventures formed through privatisation.

The public corporation is created by a particular Act of Parliament for particular objectives specified therein¹⁰³. Therefore, the objectives for the establishment of a particular public corporation vary from one corporation to another and from one country to another. However, a general justification for the establishment of public corporations remains the one given in the Morrisonian theory of public enterprises: that they are established to fulfil some key social and economic purposes which the private sector cannot fulfil because of market imperfections¹⁰⁴. Private investors are loss averse and therefore cannot invest in risky projects. Since these projects are important to the public and the tax payer needs their services, the government has to establish enterprises to serve public purposes by using public resources.

One problem which springs from the above formulation is who should be the legal owner and therefore the controller of these enterprises. At least one general answer to this problem is possible: the public, the tax payer, is the owner of the enterprises. But how can the public control these enterprises? The concept of public accountability was introduced as the solution to the problem.

Briefly described, the principle of public accountability was introduced to ensure that public enterprises operate efficiently and independent of the government. Further, that although these enterprises are required to implement government policies, the minister concerned remained accountable to the public via the Parliament¹⁰⁵. Thus, the management of enterprises had to be given autonomy to efficiently organise the enterprises and services they provided to the tax payers. This is why these enterprises had to have their own legal personalities and other rights, just like private corporations.

However sound this theory might be, its realisation in practice presented many problems. First, 'to say that efficiency is what is required of the corporation amounts to an oversimplification, for it has little meaning unless all the criteria [for accountability] are kept in view and followed up'¹⁰⁶.

¹⁰³In Britain it can be provided for by the Royal Charter or Act of Parliament. In Tanzania by the Act of Parliament or The Companies Ordinance (Cap. 212). On Britain see Ramanadham V.V., Public Enterprises in Britain, (1959), London: Frank Cass & Company Ltd. pp. 15 - 16; On Tanzania see Mwapachu Juma, Management of Public Enterprises in Developing Countries: The Tanzanian Experience, (1983) New Delhi: Oxford & IBH Publishing Co.

¹⁰⁴Morrison Herbert, Government and Parliament, (1954), London: Oxford University Press, pp. 247 -285.

¹⁰⁵Morrison *ibid.* pp. 255 - 256; Ramandham *supra* n. 103, pp. 153 - 154.

¹⁰⁶Ramandham *ibid.* p.117.

Moreover, these criteria depend on the objectives for the establishment of a particular enterprise. One cannot say that the Board's decisions should not take account of social policy when the objectives for the establishment of the enterprise were based purely on social policy.

The situation is even worse when considered from the developing countries' experience. In these countries 'the involvement of the Morrisonian theory has been more in the establishment of an enterprise than in its operation'¹⁰⁷. At best it has served as a function in the evasion of political responsibility - 'when things go seriously wrong, the "autonomous enterprise" can be made to take the blame'¹⁰⁸. But the real cause of the mischief is not fully disclosed.

In countries which had a planned economy such as Tanzania and Zambia, for example, there was considerable confusion as to who was responsible for what. It was not clear who was the "Minister" (whom Herbert Morrison had in mind) between the Prime Minister, the Minister for Finance and the Minister of the parent ministry. In many instances public enterprises were subjected to different directives from all these ministers, albeit contradictory in nature. This situation was exacerbated by the fact that when the ministers made directives to the enterprises, even those which resulted in inefficiency, they were not accountable to anybody. In short, to echo Ghai's words, the public sector was used extensively as a form of patronage and as a device to channel resources to the ruling political party leaders and build their economic base¹⁰⁹.

The failure of public enterprises in most developing countries therefore, should not be attributed to their being "public" or to bad management alone, unless management is construed generally to include the government. The sharp distinction between the minister and the enterprises that underlay the Morrison's concept was not adhered to in some developing countries. Boards of directors in developing countries are better regarded as extensions of governments than as shields for enterprises' management. Government ministers or permanent secretaries may be chairmen of the Boards¹¹⁰. Other members of the Boards are elected on political grounds, not on grounds of their managerial skills. If the board is an extension of the government, then the management is an extension of the bureaucracy. This proves that you cannot separate individual interests from collective interests or vice versa. The question is whether the introduction of a "private" element will reverse the situation in developing countries, where the anticipated market forces, are mostly under-developed. To put it differently, will the deregulation process simply legitimise the

¹⁰⁷Ghai supra n. 67, p. 551. Public enterprises were also justified in developing countries as important instruments in building the infrastructure and macroeconomics management.

¹⁰⁸ibid. p. 551.

¹⁰⁹ibid. p. 552.

¹¹⁰According to Ghai, ibid. p. 553, the former presidents of Tanzania and Zambia used to be chairmen of some leading Public Enterprises in their countries.

monopoly powers which government leaders had been maintaining "illegally", through "public" enterprises¹¹¹? The prospects of joint ventures formed under the banner of privatisation thus remain uncertain.

2:3. CHARACTERISTICS OF THE JOINT VENTURE.

The motives of both TNCs and developing countries and the objectives of joint ventures that they form, when analysed together, reveal several common elements or issues which may help in understanding the joint venture phenomenon.

2:3:1. Pursuit of Complementary/Common Commercial Interests.

It has been argued that a joint venture can best be termed as a "co-operative conflict" structure because it is characterised by both co-operative and conflicting objectives¹¹². However, for a joint venture to succeed, co-operative objectives need not be common or the same, but complementary. Complementary objectives or interests in this study refer to objectives of parties which can be achieved by using more or less the same means or mechanism. It is therefore the mechanism or relationship (joint venture) used for achievement of parties' objectives which must be of a co-operative nature¹¹³. For example, in a situation where two men in a study room have conflicting interests over the window: one wants to keep it open, because he wants to enjoy fresh air, another wants to keep the window closed, because he wants to avoid dust from outside, the construction of a window in the opposite wall may be a sufficient mechanism to resolve their conflicting interests¹¹⁴.

Complementary objectives or interests may be discovered by understanding the ultimate benefits or goals that the parties intend to achieve from the co-operative mechanism. Consider an example of two sisters who had one orange to share between them. After a long period of bargaining they decided to use an approach which they regarded as fair, namely to divide the orange into two

¹¹¹According to Prosser, supra n. 91, pp. 42 - 43, 'the danger is that a network of links between government and privatised concerns may develop in a similar way, but without even the limited degree of published framework or of institutional scrutiny, applying to the relations of government with nationalised industries. Moreover, this could occur through private law largely immune to public law means of scrutiny'.

¹¹²Navetti supra n. 15, p. 5.

¹¹³Charles P. Oman, 'Co-operative Strategies in Developing Countries: The New Forms of Investments' in Contractor and Lorange, supra n. 36, Ch. 22, pp. 383 - 385.

¹¹⁴The parties will work together (joint venturing) to construct the opposite window because it is for their mutual benefits to do so. This example is taken from Fischer Rodger and Ury William, Getting to Yes: Negotiating Agreements Without Giving in, (1982), London: Hutchinson, p. 41.

halves, each sister taking one half. However, after the division, one sister used her own half to make some juice out of it. The other sister used the refuse of her half to bake a cake and threw away the inner part. Had the two sisters disclosed their ultimate interests in the orange, a co-operative mechanism would have been devised whereby one sister would have obtained more juice, and the other more cakes, out of the same orange¹¹⁵. Therefore, having full or equal information and its disclosure by parties may help to form or maintain a co-operative joint venture. This does not only help in the determination of a formula for sharing what is produced under joint efforts, but also removes the danger of mutual suspicion¹¹⁶. It shows further that the joint venture will in most cases involve a small number of participants who can easily understand each other's interests or motives and who have confidence and trust in each other¹¹⁷.

2:3:2 Ownership or Profit/loss sharing and Common Control.

One necessary consequence of complementarity in the joint venture is that its ownership, risk of loss, profit and control have to be shared. In other words, complementarity necessitates active participation of all parties in all aspects of the venture. However, the term "sharing" needs qualification. Since the interests of parties to a joint venture need not be the same but may be complementary, each party has a different stake and therefore seeks a different kind of profit from the joint venture. But since the achievement of each party's goals depends on the participation or achievement of those of the other party, there is an element of mutual control or interdependence. Otherwise, the unsuccessful joint venture results in each party's loss. Hence, the element of loss sharing.

However, ownership, loss or reward which each venturer undertakes or receives may not necessarily be measured in terms of conventional profit and loss accounts¹¹⁸. Some co-operative ventures or mechanisms are mere conduits or facilitators of parties business, rather than profit centres, whereas others may be profit or loss centres¹¹⁹.

It is not apposite therefore, to regard as joint ventures only those structures in which ownership is shared equally (50-50). Indeed this raises the question (discussed shortly) of whether a 50 - 50

¹¹⁵Ibid. pp. 384 - 385.

¹¹⁶Linklaters & Paines, *Joint Ventures*, (1990) London, : Longman, p. 3. However, this is more possible when there is full disclosure on both parties. In the case where one of the parties has concealed his/her bottom line there is a danger of one party extracting all the surplus at the expense of the other.

¹¹⁷See Herzfeld, *supra* n. 39, pp. 9 - 10.

¹¹⁸Ibid. p. 4.

¹¹⁹For example, joint ventures may be established as a mechanism for technology transfer, research and developments projects, assembling plants of different components from the parties, etc. More discussion of these forms is provided *infra*, pp. 35 - 51.

percent equity ownership, is the only criterion for determination of equity joint ventures¹²⁰.

2:3:3 Bargaining Power and Common or Joint Control.

The fact that the 50 - 50 criterion or mechanism is not adequate in the determination of a joint venture, raises questions as to how parties determine and maintain complementary objectives or interests in the joint venture structure or relationship. In an attempt to answer these questions, the element of bargaining power and control is important.

Developing countries have been blamed for using legal means to enhance their bargaining power in joint ventures with TNCs, by forming what have been termed as "forced joint ventures"¹²¹. However, this blame may be unfair, despite the fact that it is based on factual evidence. This is because it limits the meaning of forced joint venture to one formed as a result of legislation. Consequently it gives an impression that the formation of forced joint ventures may only be occasioned by the side with legislative power. However, if considered from a wider perspective, a forced joint venture may result from the use of superior bargaining power or control by one party to interfere in the activities of the other, weaker party, beyond the realm of the activities which are relevant to the formation of a joint venture (complementary objectives). Bargaining power may be acquired through economic and legal as well as political means. For example, economic means are used when local companies are required to form joint ventures with TNCs as a precondition for getting foreign loan capital¹²². Within a single joint venture economic means may be used through exercise of superior technology, managerial skills and ownership of advanced capital assets by one party to control or make weaker parties dependent. An example of political means may include joint ventures which are now formed in developing countries because of privatisation.

Problems which arise from misuse of superior bargaining power are numerous. The general expression of these problems is that partners will have objectives which cannot be accommodated together, because they are not complementary but competing. This will reduce their actual performance, hence the joint venture's efficiency. At best the joint venture will serve the interests of one party who will be able to use legal, economic or political leverages to force other parties into dependency, and therefore control them. The formation of a forced joint venture may also obscure efforts to look for more appropriate business structures¹²³.

¹²⁰Infra pp. 46 - 50; According to Charles, supra n. 113, p. 400: 'Many companies have found that as ownership of equity does not necessarily imply effective control, so minority or zero equity does not necessarily imply inadequate control'.

¹²¹See our discussion supra pp. 18 - 21; Poynter supra n.39, pp. 1 -6.

¹²²See our discussion supra pp 18 - 21.

¹²³According to Killing, supra n. 3, pp. 120 - 121: 'Some firms need joint ventures only to solve temporary problems. For example, market penetration, financial resources.... There may be no need to create a

Formation of a joint venture in itself is not therefore, an assurance that the goals of each party that lead to its establishment will be achieved. There is a need to ensure that the joint venture formed is a true joint venture, in the sense that it includes, *inter alia*, the elements discussed above. Further, it is necessary to ensure that parties with superior bargaining power do not misuse the joint venture mechanism at the expense of others. This can only be achieved if such considerations are addressed in the legal framework for joint venture formation and operation.

2:4. THE LEGAL MEANING OF THE JOINT VENTURE.

A central difficulty in the legal analysis of joint ventures is the lack of a sharp definition that would distinguish them from other inter-firm contractual arrangements or business entities¹²⁴. Many attempts to define joint ventures tend to be limited to specific areas or disciplines. It seems (at least for the time being) the mere expression "joint venture" is of no particular legal significance; it is adopted only to describe a commercial or business arrangement or relationship, not a legal one. The legal consequence and legal meaning of joint ventures therefore depend upon which of the several possible legal forms the joint venture takes¹²⁵.

Some competition law commentators define a joint venture as a form of integration of economic activity by previously independent undertakings, by which the participants create a jointly-controlled enterprise to which they both make an input of resources in some form of capital, personnel, know-how, good-will, etc.; and to which they also allocate a particular function, which was either previously the responsibility of a participant, or would have been had the participant been involved in that field¹²⁶. This definition is vague, because calling a joint venture a form of integration by "previously independent undertakings" may imply that parent undertakings, after forming a joint venture, are no longer independent. It would seem this definition was an attempt to expand the definition provided by Article 3 of the EEC Mergers and Joint Ventures Regulation,¹²⁷ which defines joint ventures as undertakings that are jointly controlled by several

permanent joint venture company for that, to regret later. There are ways of solving these problems....Management experts can be hired on the open market....The joint venture can be postponed until it is undertaken alone'.

¹²⁴Brodley F. Joseph, 'Joint Ventures: An Antitrust Policy', 95 Harv. L. Rev., (1985), 1523, 1524.

¹²⁵Ibid. p. 1525. It seems in the EEC the aspect of joint ventures is comparatively developed in Competition Law rather than Commercial or Company Law. The commercial legal forms of joint ventures are discussed *infra* pp.35 - 51.

¹²⁶Downes Anthony and Jullian Ellison, The Legal Control of Mergers in the European Communities, (1991), London: Blackstone Press Ltd., p. 133.

¹²⁷EEC Reg No. 4064/89, discussed in Downes and Ellison *ibid.* pp. 273 - 275; Fine Frank, L. Mergers and Joint Ventures in Europe, (2nd. edn.) , (1994), London: Graham and Trotman.

other undertakings - parent companies.

Although this definition implies that parties, after the formation of a joint venture, are no longer independent of each other, other writers on competition law maintain that the formation of the joint venture undertaking should leave the parties *inter-se*, and the joint venture itself, independent undertakings or competitors¹²⁸. It seems this latter interpretation has been adopted by the EEC Competition Law¹²⁹.

Company Laws or Commercial Laws generally, of countries which follow the Anglo-American legal system, do not define the joint venture as a specific legal form of business association¹³⁰ despite some attempts by the court.

Courts have approached the joint venture phenomenon with caution. While they indicate that the joint venture is a new type of business arrangement, they are not prepared to declare that the joint venture deserves a distinct legal structure. Thus, they have tried to align it with or differentiate it from the "old" legal forms of business arrangements like companies, partnerships, trusts, agencies, etc. For example, in the New Zealand case of *Commerce Commission V Fletcher Challenge*¹³¹, MacGechan J, quoting from the Australian case of *United Dominions Corporation Ltd. V Brian Pty, Ltd.*¹³² said *inter alia* that:

'The term "joint venture" is not a technical one with a settled common law meaning. As a matter of ordinary language, it connotes an association of persons for the purposes of a particular trading, or other financial undertaking or endeavour with a view to mutual profit, with each participant usually (but not necessarily) contributing money, property or skill. Such a joint venture will often be a partnership. The term is, however, apposite to refer to a joint undertaking or activity carried out through a medium other than a partnership; such as a company, a trust, an agency or joint ownership'.

In America, courts have defined a joint venture as 'an association of two or more natural or legal

¹²⁸Brodley supra, n. 124, p. 1526; Fine ibid; OECD, *Competition Policy and Joint Ventures*, (1986), Paris: OECD, pp. 11 - 12.

¹²⁹See for example the interpretation provided in the case of *Lucas V Eaton*, [1991] EC O.J.C. 328/15, see generally Overbury, Colin (Ed.), *The EEC Merger Regulation*, (1992) London: Sweet & Maxwell, at p. 61.

¹³⁰However, some Commonwealth countries have started to make provisions on joint ventures in some of their commercial laws, for example, according to the Australian Trade Practise Act of 1974, (sec. 4J), for purpose of that Act: '(a) a reference to a joint venture is a reference to an activity in trade or commerce-
(i) carried on jointly by two or more persons, whether or not in partnership; or
(ii) carried on by a body corporate formed by two or more persons for the purpose of enabling those persons to carry on that activity jointly by means of their joint control, or by means of their ownership of shares in the capital, of that body corporate'.

Taken from Latimer Paul, *Australia Business Law*, (12th edn.), (1993), Sydney: CCH Australia Limited, p. 595.

¹³¹(1989) 2 NZLR, 554, 614.

¹³²(1985) 157, C.L.R 1, at p. 10.

persons contributing property and expertise to carry out a single business enterprise and having a joint proprietary interest, a joint right to control, and sharing of profits and losses'¹³³.

In England however, although it is still generally accepted that an 'association which is neither a corporation nor a partnership is unknown to the Common Law'¹³⁴, Lord Brett in Smith V Anderson¹³⁵ was not sure whether 'by the ingenuity of men of business, there might not some day be formed a relation among...persons which, without being strictly either a company or a partnership, might be yet an association'. Indeed, later in Abrahams V Herbert Reiach Ltd.¹³⁶ Lord Atkin could identify 'the transaction [which] resembles an agreement for a joint venture falling short however of a partnership'.

Therefore, it seems as far as case law is concerned, apart from indicating that in the joint venture there must be joint contribution, joint control, profit and loss sharing, courts have not yet gone beyond aligning joint ventures with or differentiating them from existing legal structures such as partnerships and companies, to try to establish a new business legal structure, known as the joint venture. As such, joint ventures cannot be limited to a particular legal form of business association, whether a partnership or a company. 'What is required to progress matters onwards to joint venture status is some contractual association of persons for the purpose of a particular trading...undertaking with a view to mutual [control and] profit'¹³⁷. Thus, the joint venture may take a partnership, a company or a mere contractual legal form, provided that the elements that have been discussed above are included and cause that legal business relationship to be understood as a joint venture¹³⁸. These elements may be enshrined in the formation contract and may be exercised in ownership, the right to use or operate all or some of the joint venture assets, etc. As regards joint ventures which take the form of a company these elements may be included in the documents which facilitate the legal formation and operation of joint venture companies. At an operational level they may be exercised through influence over the corporation; voting rights on the general meeting and the board; decision making powers as to managing or supervisory bodies, and through contracts which give a party power to run the business of the joint venture.¹³⁹

¹³³ Millis V Bankers Trust Co. Ltd., (1983) 717, F2d. 683; See also Linklaters and Pines, Joint Ventures, (1990), London: Longman, p. 2.

¹³⁴ Halsbury Laws of England, 4th edn. (1988), para 1, footnote 5.

¹³⁵ (1880) 15 Ch.D, 247, 277.

¹³⁶ [1922] 1. K.B. 477, 482; The term "joint venture" is also used in relation to group accounting requirements in the English Companies Act (1985) as amended in 1989, para 19 of Sch. 2 and para 21 of Sch. 3.

¹³⁷ Commission V Fletcher, supra n. 131, pp. 615 - 616.

¹³⁸ Thus, it is because of this fact that Herzfeld supra n. 39, at p. 7 defines the joint venture as: "an enterprise, corporation or partnership formed by two or more companies, individuals or organisations, at least one of which wishes to broaden its activities for the purpose of conducting a new profit-motivated business of permanent duration. In general the ownership is shared by the participants with more or less equal distribution and without absolute dominance by one party".

¹³⁹ More discussion on the internal structure of joint venture companies is provided in chapter four infra pp.

The issue which remains unclear however, is how to accommodate these elements in the definition of a joint venture. This is particularly difficult in respect of the notion of reconciling joint control and mutual dependence (or complementarity) with the independence of parents after the formation of the joint venture.

The above cited cases seem to indicate that for a joint venture to be formed there must be joint contribution, joint control, and profit and loss sharing. However, they do not discuss the relationship of parties *inter-se*, and with the joint venture after its formation. This is very important in order to determine a separate or independent existence of the joint venture. For if the joint venture is identified with one of the parents, its existence as an economically independent entity for the purposes of our study becomes questionable.¹⁴⁰ Brodley's definition points out that parent undertakings must be under no related control. This means that they must remain independently controlled otherwise the joint venture formed will be a subsidiary of the controlling parent¹⁴¹. Downes and Ellison's definition has some indications that the previously independent parent companies are no longer independent as far as the joint venture is concerned after its formation¹⁴². It would seem therefore, that as far as the joint venture context is concerned the parent undertakings are interdependent or mutually dependent. Yet, in their relationship with each other, they are independent. In so far as there is interdependence between the parents, and neither of them can establish the undertaking on its own, the joint venture undertaking is a form of co-operation between independent parties. On the other hand, as far as the businesses of parents are concerned, they are under no related control, and therefore, they are independent and actually or potentially competitive. It is in this context that the term "co-operation" will be used in this study.

Co-operation is a form of relationship between two or more persons, who may previously be unacquainted with each other, with the aim of helping each other to reach or obtain what is needed or sought (their various goals)¹⁴³. When considered in this context, interdependence generally means a situation in which more than one single agent is needed to cause a certain event or events to happen¹⁴⁴. Hence, co-operation may take place between companies which cannot establish any form of a separate entity independently, because their contributions and therefore

105 - 145.

¹⁴⁰This is because, as indicated in the first chapter, the aim of our research is to study the legal framework of joint venture companies as independent entities, not as subsidiaries of one of the parties and for that matter, not as joint subsidiaries.

¹⁴¹Supra n. 124, p. 1526.

¹⁴²Supra n. 126, p.133.

¹⁴³Robert A. Hinde (Ed), Co-operation and Pro-social Behaviour, Cambridge: Cambridge University Press, p.4; Colman M. Andrew, (Ed), Co-operation and Competition in Humans and Animals, Workington: Van Nostrand Reinhold (UK) Co. Ltd., p.p. 3 - 5; Compare with the definition provided by Buckley, 'A Theory of Co-operation in International Business' in Contract and Lorange, supra n. 36, p. 32.

¹⁴⁴See our discussion in chapter three infra pp. 85 - 87.

their interests are complementary. If these companies decide to form a single business structure, that structure may be referred to as a joint venture. Therefore, a joint venture may be defined as a form of co-operation of economic activities between independent undertakings, establishing a jointly controlled undertaking or enterprise to which they jointly make an input of resources (capital, personnel, property, skill, etc.) with a particular function of running the economic business which neither of the parties is able to run independently, or which is better run jointly.

In the context of our study therefore, a joint venture company means an enterprise established according to the laws of the host country (developing country) between on one hand, a transnational corporation (TNC), and on the other, a private or public corporation, or the government of the host country. The enterprise is one which neither of the partners could have established independently or operated efficiently alone, given the interdependent social, economical, political and legal factors between the partners. It is this form of a joint venture company which will be the concern of this study. However, in order to provide a general understanding of the joint venture company we shall first have to distinguish it from other legal forms of joint ventures, whether incorporated or un-incorporated.

Joint venture undertakings are different from mergers, consolidations, take-overs and other means whereby two or more undertakings join together to form a single business undertaking. While in joint ventures parent undertakings remain independent legal entities as shareholders in a new company in other forms either one undertaking is absorbed or both undertakings cease to exist as separate entities and form a new undertaking. A merger, for example, is a company formed when two or more companies are merged together, given the fact that they are totally interdependent of each other¹⁴⁵. In a take-over one company takes the controlling interests in the shares of another company. In this case the "taken-over" company is dependent on the other. Therefore, a joint venture undertaking falls short of a full merger or a take-over¹⁴⁶.

2:5. LEGAL FORMS OF JOINT VENTURES.

The problems that are encountered in defining a joint venture may be responsible for difficulties in determining its legal form. Despite the fact that the joint venture is a novel phenomenon, one thing is clear: like other commercial relationships, the joint venture is essentially contractual. However, unlike other commercial relations, it has no distinct legal regime, at least in the Anglo-

¹⁴⁵Farar, Furrey and Hungton, Farrar's Company Law, (3rd edn), (1991), London: Butterworths, p. 730; Fine Frank *supra*, n. 127, p. 3.

¹⁴⁶Farar *ibid.* p. 730.

American legal system. Therefore, it may be unfair to classify the joint venture as "a non-specialised area" of partnership¹⁴⁷. Although we intend to discuss this anomaly in detail in the next chapter, it is important at this juncture to emphasise that joint ventures as a category of commercial relations should not be confused with the legal vehicles or structures which they take in order to conduct their business. It must be understood that inter-corporate commercial relations involve two or more corporations and can take different legal forms. Between the two extremes of their transactions, (on-spot transactions, on one side and complete merger or take-over on the other) lie a range of co-operative and competitive arrangements. It is in this middle area that all forms of joint ventures lie. Therefore:

'What confronts us is a continuum passing from transactions such as those on organised commodity markets, where the co-operation element is minimal, through intermediate areas in which there are linkages of traditional connection and good will, and finally to those complex and interlocking clusters, groups and alliances which represent co-operation fully and formally developed'¹⁴⁸.

2:5:1 Contractual Joint ventures.

(a) General.

As the name implies, contractual joint ventures are formed between two or more companies by way of a contract. In such cases the contract is the only legal vehicle for the parties' commercial relations. In countries which follow the Anglo-American legal system, contractual joint ventures are governed by the classical principles of contract law. According to this law, it is presumed that parties are well informed, in such a way that their interdependent objectives are negotiated at arms-length and completed by the *ex-ante* bargaining.

Contractual joint ventures are usually adopted by parties in situations where most of parties' business remains independently controlled, interdependence (co-operation) being limited to a particular field of activity. Such joint ventures are easy to set up and relatively short lived.

What makes joint venture contracts different from other contracts is the fact that the joint venture agreement is not an on-spot transaction. It involves an element of long-term operation or execution. This has led some writers to refer to it as a joint operation agreement (JOA)¹⁴⁹. The long-term and operative nature of the contract makes it necessary for parties to look for the same operational mechanisms or means of execution. The agreement establishing the joint operational mechanisms is therefore a *sine qua non* for the existence of contractual joint ventures. Whereas in

¹⁴⁷In *Commerce Commissioner V Fletcher*, supra n. 131, at p. 616, the Judge was of the view that '... it may be that partnership is simply a specialised development of one area of joint venture (my own emphasis)

¹⁴⁸Richardson G.B. 'The Organisation of Industry' *82 Economic Journal* (1972), 883 - 896, at p. 887.

¹⁴⁹See note 150 infra.

the typical contract the supplier and the buyer negotiate about the exchange of the already finished materials, in contractual joint ventures the negotiation is not only about the exchange but also about the means of executing the exchange. It is the latter which helps to accommodate their complementary interests. In most cases the contractual joint venture mechanism involves structures such as an operator and an operating committee, which act as execution agents under the joint venture agreement.¹⁵⁰

Examples of contractual joint ventures between TNCs and developing countries include:

(i) Industrial property agreements, accompanied by technical assistance and management agreements.

In these agreements TNCs contract with companies from developing countries or their governments to grant their industrial property rights to the latter in return for royalties which are calculated on the basis of profits made from product sales. The idea of joint venturing arises because technical experts from TNC work with technical experts from local companies to ensure that local experts understand how to use the technical rights the local company has bought from the TNC. This process results in the formation of consultancy and, sometimes, management agreements. Since it is the co-operative effort of experts from both sides which ensures better production in terms of quality and quantity and, thus better benefits to both parties the technical assistance and management agreements become a joint mechanism for achieving joint benefits from the transferred technology. In management agreements the TNC contracts with the local company to manage the business and the organisation of the local company together with the local management, thereby transferring management skills to them for a fee which is obtainable from improved production and profits from sales.

(ii) Research & Development, and Exploration Joint venture Agreements.

Contractual joint ventures also may be established where two companies, because of complementary knowledge or capabilities start a relatively long-term project, usually in research and development¹⁵¹. Because the project is of a relatively long duration, and does not generate

¹⁵⁰Mildwaters Kenneth Charles, Joint Operating Agreement: A consideration of Legal Aspects, (1990) Ph.D Thesis: University of Dundee, chapters 11 & 12 pp. 384 - 612; Bean Gerard M.D, Fiduciary Relationships, Fidiciary Duties and Joint Ventures: The Joint Operating Agreement, (1992), Ph.D Thesis: University of Cambridge, chapter 1 pp. 14 - 18.

¹⁵¹Contractor and Lorange, 'Why Should Firms Cooperate? The Strategy and Economic Basis for Co-operative Ventures' in Contractor and Lorange supra n. 33 pp. 5 - 6.

profit on its own, it is widely known as a contractual joint venture. Joint ventures of this kind are always concluded by parties whose level of interdependence is relatively high, and the contract is regarded as an experiment which may lead to further co-operation in more complex forms of joint ventures (i.e., partnership and corporate joint ventures). Co-operative joint ventures of this kind are also frequently used in minerals and oil exploration ventures¹⁵².

(b) Advantages and Disadvantages of Contractual joint ventures

(i) Advantages.

The main advantage of contractual joint ventures is that, *prima facie*, they leave contracting parties independent of each other. Therefore, parties are able to operate as independent economic entities while fulfilling their obligations in the contract and afterwards.

Secondly, although a joint mechanism for execution of the joint venture agreement is created, it does not amount in law to the creation of a separate independent entity. Thus, there is no joint liability or any mechanism for transferring liability from one joint venturer to another or to the joint venture itself. Each venturer bears its own liability, in accordance with the joint venture contract, unless the contract is varied by the agreement of the parties.

Thirdly, the establishment of the joint venture contract is flexible. Parties are not involved in cumbersome legal procedures as far as their establishment, operation and termination is concerned. Joint venturers are also free to choose the law that will apply in the enforcement of their agreements, and the arbitrator.¹⁵³

Fourth, contractual joint ventures are useful in maintaining secrecy because, unlike structures such as companies, they are under no legal requirement of registration or disclosure.

Tax transparency is another advantage of joint venture contracts. Since joint venture contracts do not create legal entities, they are in most jurisdictions not subjected to tax. Income from these arrangements is taxed in the hands of the joint venturers themselves.

Contractual joint ventures may be easy to terminate. Their termination does not entail liquidation

¹⁵²Refer to the research by Mildwaters and Bean *supra* n. 150; Ongieu Sarah 'Joint Ventures and Fiduciary Obligations' *22 VUWLR*, (1992), 265 - 283, 266.

¹⁵³See our discussion in chapter six.

and dissolution procedures, as is the case in joint ventures which create separate entities, such as companies.

There are specific advantages from joint venture contracts for both the TNC and local companies. For example, consultancy and management contracts are good ways of investing intangible property in developing countries without involving the TNC in the conflicts of "foreign" versus "local" ownership of enterprises. The joint venture contract device can be used by the TNC to achieve its objectives even if it has zero ownership in the enterprise. The power which the TNC has in the contract to influence technical decision making and planning may be enough to give it control over a dependent local company¹⁵⁴.

However, when these individual advantages are given priority over the mutual advantages, the sense of joint venturing becomes doubtful. Because of their flexibility, parties include in joint venture agreements a re-negotiation clause¹⁵⁵, so as to re-adjust their positions if changes appear to be necessary in the mode of execution of these agreements. Such provisions cannot be fully accommodated in the classical contract law principles which regard *ex-ante* negotiations as final and conclusive.

The fact that these arrangements differ from classical contractual arrangements has been the subject of discussion by different analysts of contract law.¹⁵⁶ The *lacuna* or uncertainty in the law as regards these arrangements, inevitably adds to problems.

(ii) Disadvantages.

One of the disadvantages of contractual joint ventures is the problem of handling issues of liability to third parties. The nature of joint venture contract may require one or both parties to engage in transactions with third parties in the process of executing the joint venture contract. If transactions with third parties are not fully discussed during the *ex-ante* negotiations, parent companies may have problems of determining *ex-post* who is liable for what, as far as the third party is concerned. Thus, the lack of external flexibility may be a serious disadvantage to the contractual joint venture in financing or trading with it.

¹⁵⁴Gabriel supra n. 39 pp. 28 & 92.

¹⁵⁵See our discussion in chapter six pp. 234 - 240.

¹⁵⁶MacNeil Ian, *The New Social Contract*, (1980), London: Yale University Press, pp. 39 - 41; Kennedy D. 'Form and Substance in Private Law Adjudication', 89 *Harv.L.Rev.*, (1976), 1685; Katz Avey, 'The Strategic Structure of Offer and Acceptance: Game Theory and The Law of Contract' 89 *Mich.L.Rev.*, (190), 216 Klein A. William, 'The Modern Business Organisations: Bargaining Under Strain', 91 *Yale L.J.*, (1982) 1524..

Secondly, contractual joint ventures sometimes suffer from misuse of the autonomy that joint venturers enjoy under the contract. As the joint venture contract may not be negotiated at arms-length, some parties may misuse *ex-post* joint venture opportunities at the expense of others. Since there is no specific law to protect innocent parties, the joint venture may suffer from premature termination. Several writers¹⁵⁷ argue that there should be a fiduciary relationship between joint venturers who use a joint venture contract.

Thirdly, contractual joint ventures have a limited scope or field of use. The lack of external flexibility and the absence of a joint legal vehicle (entity) narrow the field of their application to circumstances in which the formation of other structures is not appropriate. Thus, contractual joint ventures may not be good mechanisms for raising loan capital for the venture because of the absence of a legal entity. Loans have to be negotiated and guaranteed by the parties themselves.

Fourth, contractual joint ventures risk being classified as partnership joint ventures, sometimes against the wishes of the parties, when their formation and operation conform to partnership laws¹⁵⁸. In order to avoid this a clause is included in some contractual joint ventures stating that no partnership is created.¹⁵⁹

Joint venture contracts which include consultancy and management agreements pose another disadvantage for the local company. This is because in some instances it is difficult for these agreements to stipulate specifically and sufficiently the extent to which the management of the TNC can disregard the directions of directors of the TNC in favour of the local company's directions. This will raise problems when those directions are in conflict. In one sense, it is meaningless to say that the management provided by the TNC can disregard the directions of the TNC, its employer. After all, the local company's directors cannot direct on matters in which they lack technical know-how and managerial skills, which is the reason for the establishment of joint venture agreements with TNCs. In many instances consultancy and management agreements subject local companies to complete *de facto* control by the TNC, in which case the local companies may be better regarded as subsidiaries "taken over" by TNCs, (albeit for a limited time) rather than independent companies.

¹⁵⁷Mildwaters supra n. 150 pp. 373 - 380; Bean supra n. 150 pp. 64ff; Ongley supra n. 152 pp. 265ff.

¹⁵⁸In France for example, they may create what are known as *de-facto* partnerships, see Ashurst Morris Crisps, et al. *Joint Ventures in Europe*, (1991), London: Butterworths, p. 19; in Germany see loc. cit. p. 64.

¹⁵⁹Bean supra n. 150, p. 95.

2:5:2 Partnership Joint Ventures .

(a) General.

Joint venture partnerships are structures which go further than contractual joint ventures *per se*, but fall short of corporate joint ventures. The expression "partnership" is generally used to refer to the relations which subsist between persons carrying on a business in common with a view of profit.¹⁶⁰

One aspect which differentiates contractual joint ventures from partnership joint ventures is the fact that parties to the latter are under joint and several liability.¹⁶¹

No English court has decided whether the contractual joint venture is different from the partnership. However, the issue has been considered elsewhere. In the Australian case of United Dominions Corporation Ltd. V Brian Pty Ltd.¹⁶² Dawson J. was of the view that because it is the product rather than the profit that is divided among co-venturers, there may be a distinction between a contractual joint venture and a partnership. This was supported in New Zealand in Petrocorp Exploration Ltd. V Minister of Energy¹⁶³ where Cooke, P. suggested that although there may be some analogy between a contractual joint venture and a partnership, the two are different.

Latimer¹⁶⁴ adds other different factors which may be used to distinguish contractual joint ventures from partnerships that: (i) in a contractual joint venture there is no an automatic legal power to co-venturers, managers or operators to act as agents of each other, or to bind each other;. (ii) Subject to the terms of the agreement, participants to a contractual joint venture can freely dispose of their interests, whereas partners can only assign their interests according to Partnership Laws.

One question which arises is whether there is a difference between a normal partnership and a joint venture partnership. It is submitted that, in this area, there has been a great deal of confusion. The confusion stems from the unresolved issue of whether the joint venture is a different business structure in law. Attempts to deal with this issue have either equated all joint ventures to partnerships or treated them as a different structure altogether.¹⁶⁵ For example, courts

¹⁶⁰English Partnership Act 1890, sect. 1(1), appended in I'anson *infra* n. 161 pp. 877 - 890 as app. 1.

¹⁶¹I'anson Banks, R,C, et al, Lindley and Banks on Partnerships, (1990), London: Sweet and Maxwell, ch. 13 pp. 320 - 371.

¹⁶²*supra* n. 132 pp. 14 - 16.

¹⁶³(1991) 1 NZLR, 1 p. 36.

¹⁶⁴*Supra* n. 129, p. 597.

¹⁶⁵Good examples of this attempt can be obtained from Mildwaters *supra* n. 150; See also McPherson, B.H,

in several instances have regarded contractual joint ventures as partnerships because, 'there is very little law applicable to partnership that is not applicable to the joint venture'.¹⁶⁶ However, for the purposes of this study it is important to note that the partnership structure should be regarded as a legal vehicle which may be used by parties to the joint venture who, apart from having joint venture elements, qualify to be regarded as partners according to partnership laws.¹⁶⁷ The joint venture thus established is referred to as a joint venture partnership.

However, joint venture partnerships may be different from other partnerships in some instances. For example, joint venture partnerships may involve companies as parties more often than other partnerships. Also, because any joint venture has to include elements of complementarity, joint ownership, joint control, and risk and profit sharing, the partnership joint venture may have some characteristics which are not usually present in other partnerships. For example, unlike other partnerships, the joint venture partnership acts as a single continuing business transaction with almost all parties participating in the operation of the firm. Again, the profit and loss that accrues to the parties from the joint venture partnership may not be measured in terms of cash, but in kind.

When these differences are studied in the light of partnership laws, a need may arise to consider amending those laws in order to accommodate the joint venture structure. However, this is beyond the scope of the present study.

Partnership joint ventures may feature in all joint venture business transactions which fall short of creating a corporate joint venture. Such ventures are common in property development projects, shared manufacturing arrangements, publishing agreements, entertainment agreements, and industrial and research agreements which involve an element of profit.¹⁶⁸

(b) Advantages and Disadvantages of joint venture partnerships.

(i) Advantages.

The main advantage of a partnership joint venture is its "privacy" or internal flexibility. The partnership agreement is regarded as a private document by the parties because they are not

"Joint Ventures as a Separate Concept", in Finn, P.D (Ed.) Equity and Commercial Relationships, (1987), Sydney: The Law Book Company Ltd.pp. 19 - 47.

¹⁶⁶Mildwaters *ibid.* p. 730.

¹⁶⁷Latmer *supra* n. 130, p. 601.

¹⁶⁸*Ibid.* p. 599.

required to observe specific legal procedures in establishing a partnership¹⁶⁹and, therefore, their negotiations may or may not be formal. The articles of partnerships are often framed in a language which is less technical and less prone to legal jargon than other corporate formal documents¹⁷⁰. This may allow members of a partnership to discover for themselves the position of their partnership without having to go to court. Nevertheless, this simplicity and privacy is not without qualifications. The court may "imply" mutual duties and obligations from the agreement when it believes that it is in the interests of justice to do so. As Lord Langdale put it:

"The transactions of partners with each other cannot be considered merely with reference to the express contract between them. The duties and obligations arising from the relation between the parties are regulated by the express contract...so far as the express contract extends and continues to be in force [of law]; but if the express contract...does not conform to all these duties and obligations, they are implied and enforced by the law'¹⁷¹.

Thus, the partnership agreement, though private, has to obey the principles of law in the Partnership Act and the general laws of contract. Moreover, some partnership agreements have to be registered under different laws¹⁷².

A corollary to the above advantage is the ease with which the documents that are used in the formation of a partnership joint venture can be varied without using the formal legal procedure required in the case of a company.

Another advantage of partnerships is their confidentiality. Because of the unlimited liability of the partners partnerships are not subject to requirements of public disclosure in the way that limited liability companies are. However, according to section 28 of the Partnership Act 1890, members, among themselves, have an obligation "to render true account and full information of all things affecting the partnership". Although it is argued that this obligation is there primarily for the advantage of the partners¹⁷³, it is now indisputable that third parties who trade with the partnership and therefore have an interest in its accounts have a right, from time to time, to see the accounts of the partnership¹⁷⁴. Notably, the Commissioner for Inland Revenue may require the production of these accounts as they are the basis for tax assessment on the individual partners.¹⁷⁵

Joint venture partnerships with corporate partners cannot fully enjoy the advantage of

¹⁶⁹Burges Robert and Geoffrey Morse, Partnership Law and Practise, (1980), London: Sweet and Maxwell, p. 43.

¹⁷⁰For example, the Memorandum and Articles of Association which have to be prepared and registered during the process of the joint venture company formation, see our discussion in chapter four *infra*.

¹⁷¹In Smith V Jeys (1841) 4 Beav. 503. at 505.

¹⁷²For example, according to the English Limited Partnership Act of 1907, sect. 5.

¹⁷³Burges *supra* n. 169, p. 177.

¹⁷⁴Trego V Hunt, [1896], A.C 7, 26, per Lord Davey

¹⁷⁵See *infra* pp. 45 - 46.

confidentiality. Parent companies (partners) will have to file their accounts with the Companies Registry and this will reveal some information regarding their interests in the partnership¹⁷⁶.

Another advantage of joint venture partnerships is that they have a flexible managerial structure, unlike companies which may be constrained by company law or other statutes. However, certain managerial duties and obligations are stipulated in the Partnership Act, 1890¹⁷⁷. Further, managerial flexibility may be an advantage to partnerships created by individuals rather than joint venture partnerships created by companies. Partners of corporate partnerships may themselves have no flexible management. If rules of partnerships are strictly adhered to, each corporate partner has the obligation and the right to manage the business of the partnership¹⁷⁸. But attempting to manage a joint venture through the boards of its parents often proves cumbersome and time consuming. Stedman and Jones¹⁷⁹ propose that it is better to create a management committee or a joint holding company to manage the business of the joint venture partnership. This may be no more than an attempt to avoid the creation of a joint venture company rather than being an advantage of creating a partnership. The creation of a joint venture company to manage the business of a joint venture partnership may, in practice, differ little from the creation of a joint venture company in the first place.

(ii) Disadvantages.

Perhaps the main disadvantage of joint venture partnerships is the concept of joint and several liability inherent in partnership law¹⁸⁰. Subject to some exceptions¹⁸¹, the liability of one partner *qua* partner is a liability of the whole partnership. Since the liability of the partners is unlimited and extends beyond the capital or assets provided by each partner to assets outside the partnership, the liability of a joint venture partnership may harm a partner company's finances, despite the fact that joint venture partnerships are usually established to run a small part of the business of the corporate partner. However, shareholders in the partner companies are protected by their own limited liability. Moreover, third parties may hesitate to trade with partnership joint ventures, especially when these ventures are created by partners from different countries, because of risks involved in the procedures to recover debts from several partners. Financial institutions

¹⁷⁶According to Schd. 4A, para 19(1) of the English Companies Act (1985) and para 19(2), in England Partnership Joint ventures are considered as proportions and consolidations of parent companies for the purposes of accounting; Stedman and Jones *supra* n. 38 pp. 175 - 181.

¹⁷⁷Sections 28 - 30 of the Act; Banks *supra* n. 161, chapter 16 pp. 410 - 421.

¹⁷⁸Section 24(5) of the Act; Invamy Herd and Jones, D.R., Underhill's Principles of Law of Partnerships, (1983), (12th edn.), London: Butterworths, p. 41.

¹⁷⁹*Supra* n. 38 at p. 173.

¹⁸⁰*Ibid.* p. 174; See further Cooke Gerald and Yates David, 'Legal Problems in Financing Maritime Joint Ventures', J.B.L. [1989] 197, 202.

¹⁸¹Invamy et al *supra* n. 178, pp. 55 - 60.

always seek the guarantee of a particular partner, rather than the partnership itself.

An associated disadvantage is the failure of the law to recognise partnerships as legal entities. They cannot hold property. They cannot sue and be sued. They have no perpetual existence. As such, they may not be a good medium for a business which involves a large sum of capital, because of the problems involved in raising and maintaining capital.

However, tax considerations are even more important. The tax charged to partnerships and corporations varies from country to country. The partnership structure may be tax efficient in one country than in another. This part discusses only general issues as to the advantages or disadvantages of joint venture partnerships from the point of view of tax. When necessary some reference are made to tax laws of England and Tanzania.

As a general rule, a partnership cannot be taxed as an entity since it is not a legal person. However, for the purpose of taxation the Inland Revenue always uses the partnership "entity" as a medium through which the income tax of the separate partners is assessed and levied. Therefore, the liability of partners, as far as tax considerations are concerned, is the liability of all the partners and not the several liability of each¹⁸². Also a charge to capital gains tax may arise to the partnership where any capital assets, being partnership property, are disposed of by the firm¹⁸³. In this case each partner is treated as having disposed of its interest in the property. The gross gain from the sale will be taxed and each partner will be taxed according to its share ratio.

While there is little difference between the taxation of partnerships and the taxation of corporations, some problems may arise in the taxation of joint venture partnerships. One problem arises from the fact that joint venture partnerships involve corporations which may reside in different countries. The solution to this problem may be to regard the joint venture partnership as a subsidiary of each parent corporation and charge each partner corporation tax on the profits arising to it from the joint venture partnership. This procedure is followed in Britain¹⁸⁴.

However, this problem may be difficult to resolve when partner companies are domiciled in different countries with no bilateral or multilateral agreements on double taxation. In situations like this, the joint venture partnership may be treated as a taxable entity.

Generally, the partnership joint venture is a very delicate medium for joint venture business. This

¹⁸²Harrison V Willis Bros. [1966] Ch.D 619; Innamy et al supra n. 178 chapter 8 pp. 300 - 339.

¹⁸³Milliman and Flanagan, Modern Partnership Law, (1983), London: Croom Helm, p. 96.

¹⁸⁴English Taxes Act 1988 ss. 8(2) and 144(2); Stedman and Jones supra n. 38, pp. 175 - 177.

is mainly due to the lack of adequate legal protection to the parties. Thus, they should be adopted only when parties are absolutely certain of their reciprocal trust and confidence.

2:5:3 Corporate Joint ventures.

(a) General.

Corporate joint ventures or joint venture companies form the last category of legal forms of joint ventures. Companies are always differentiated from other business structures on the ground that companies are legal entities while others are not¹⁸⁵. Therefore, the joint venture company may be differentiated from other forms of joint ventures on the same grounds. As we shall see in the next chapter this ground of differentiation is increasingly being questioned¹⁸⁶.

Other companies however, may be different from joint venture companies. As a matter of necessity, in order for a company to be regarded as a joint venture company, the internal relations of its actors should reflect the elements of any joint venture, namely: complementarity, shared ownership, shared profit and loss and joint control. Thus, while in other companies registration may be enough to achieve legal formation, in the joint venture company the *regulation of the internal relations* of parties so as to reflect the above elements is necessary.

While other companies may be regulated internally by hierarchical command, in a joint venture company, because of these elements, hierarchical command is replaced almost totally with negotiation between corporate actors. Thus, in the joint venture company, rather than having a single power of command at the top, command or control is shared between all participants. According to Brodley¹⁸⁷:

'Compared with a single firm the joint venture [company] is a cumbersome organisation. Control is divided, creating a problem of two [or more] masters. If joint ownership is divided equally, as it frequently is, deadlock in decision making may occur. Thus, *negotiation must replace hierarchical command* if a balance is to be maintained between differing economic interests and strategic objectives of the participants. Even when negotiation balance is achieved, it can be upset by changes in corporate goals, personnel or parent control'.

This makes a joint venture company a specie of closely held corporations whose members have mutual interests and confidence and where all members participate actively in the affairs of the company. Further, it explains why the joint venture company may share similar characteristics with what are known as "quasi-partnership" or family companies.

¹⁸⁵Based on the case of Salomon V Salomon; [1897] A.C, 22 (H.L.) Ashurst et al supra n. 158, p. 246.

¹⁸⁶See our discussion in chapter three infra pp. 54 - 60.

¹⁸⁷Supra n. 124, p. 1529 (my own emphasis).

The joint venture company is also different from other companies in the mode of capital contribution and profit or loss sharing. Since contribution is mostly in kind in the joint venture company, the emphasis is not on share capital requirements, but on minimum capital and the valuation of the non-cash contribution¹⁸⁸. Consequently, profits accruing to the members of the joint venture company need not be measured in terms of cash (dividends) as it may be the case in other companies. It may include the division of non-cash products of the venture¹⁸⁹.

(II) Advantages and Disadvantages of Corporate joint ventures.

(i) Advantages.

It has been observed by a number of writers¹⁹⁰, that parties prefer corporate joint ventures because they can utilise the advantages that law grants to the corporate structures and their actors after incorporation. Those rights and duties include; limited liability, legal personality, perpetual existence, capacity to sue and be sued and capacity to hold property.

Perhaps the main advantage of joint venture companies is the fact that the joint venture company, because it is a separate entity, has to be independent from the joint venturers. Thus, the joint venture company mechanism may be a good business structure for companies that want to solve the problems of interdependence by establishing an independent structure to take care of functions which were previously dealt with on the basis of interdependence. Because it is a separate entity, the joint venture company enjoys the advantage of raising loan capital from third parties without difficulty. Thus, compared to other structures, the joint venture company has greater external flexibility and therefore greater possibility for expansion.

The corporate joint venture is also a useful mechanism for a joint venture business because it has a formal management structure regulated by specific company laws¹⁹¹. For example, the elements of profit or loss sharing and joint control may be compromised more easily in the joint venture company than in the other joint venture structures.

Because the joint venture company is subject to company laws which are usually specific about

¹⁸⁸See our discussion in chapter four *infra* pp. 111 - 113.

¹⁸⁹See Herzfeld, *supra* n. 39, at pp. 10 - 12. More differences between joint venture companies and other companies may be gathered from our analysis in the fourth chapter.

¹⁹⁰Stelman and Jones *supra* n. 38, pp. 179 - 182.; Friedman and Kalmanoff *supra* n. 32, pp. 212 - 217.

¹⁹¹Stelman and Jones *ibid.* p. 179.

issues such as minimum capital, capital asset valuation, disclosure, accounting, etc., the use of that structure shows that the parties to the joint venture business have a high level of commitment. This should enhance the possibility of business success. Moreover, even if there is business failure, joint venture companies are subject to insolvency laws. This helps to ascertain the element of loss sharing in the joint venture company.

The joint venture company also enjoys clarity of business structure. Disputes about asset ownership or rights to intangibles such as intellectual property within the venture are less likely because they belong to the joint venture company. This solves the problem of determining who should own the property which has been developed jointly within the venture. At least before the joint venture is terminated¹⁹².

The joint venture company form is also useful for transferring parties' interests (shares) to other parties. However, we shall see in the fourth chapter that this advantage is subject to some qualifications.

(ii) Disadvantages.

Company structures have their own disadvantages, especially as far as corporate joint venturers are concerned. For example, the concept of confidentiality in companies is not as well developed as that in other joint venture structures. Companies are subject to disclosure requirements about their activities. In particular, companies have to register some documents relating to their establishment with the Companies Registrar. Their accounts have to be audited and filed with the Companies Registry¹⁹³.

When compared to other structures, the joint venture company structure is not internally flexible. Partners' relations are regulated by company laws. Important policy decisions within the venture may be delayed for want of compromise. The life of the joint venture company may be endangered if parties disagree or resort to court procedures. Since, because of interdependence, each partner has to participate in the operation and decision making of the joint venture company, some important decisions may not be reached because of deadlock.

Adherence to the doctrine of limited liability may occasion loss to third parties, particularly creditors in cases where the joint venture company's assets are worth less than its liabilities. This

¹⁹²Conflict over the division of the joint venture property when the joint venture project is terminated may happen, see for example, *B.I.C. plc. V Burndy Corporation and another*, [1985] Ch. 232.

¹⁹³See our discussion in chapter four *infra* pp. 85 - 97.

is common in situations in which a "joint venture company" is not independent but is dominated by the controlling or dominant partner company which is, in turn, protected by the doctrine of limited liability.¹⁹⁴

Joint venture companies also have to pay corporation tax. As we have seen in the case of partnerships, cross-border joint venture companies may suffer from double taxation if there is no double taxation agreement between two or more countries in which the joint venture company operates or resides.

2:5:4 Other Legal Forms of Joint Ventures.

The list of the above legal forms of joint ventures is not exhaustive. Some jurisdictions may have other legal vehicles which may be preferred by joint venturers.¹⁹⁵ Worthy of mention however is the *European Economic Interest Grouping* (EEIG)¹⁹⁶. The EEIG is a non-profit making legal structure, established to serve mostly cross-frontier business transactions between companies of the EEC countries. A joint venture formed using this structure may be known as an EEIG joint venture. The characteristics of this kind of a joint venture place it between a joint venture partnership and a joint venture company. A detailed analysis of this structure is provided in chapter five of this study.

2:6. SUMMARY AND CONCLUSION.

The period towards the end of the twentieth century has witnessed growth of world-wide commercial interdependence and the establishment of commercial joint ventures between TNCs and developing countries. The reasons for the establishment of joint ventures between these partners are numerous and varied. The motives of the parties can be accommodated together in a joint venture only if they are complementary and only if arrangements will allow joint ownership, joint control and profit and loss sharing. An analysis of these motives reveals that some are temporary and non-specific, and others are permanent and core. Those which are temporary need temporary joint venture structures, and the core motives need relatively permanent structures. In a

¹⁹⁴See our discussion in chapter four *infra* pp. 143 - 144.

¹⁹⁵For example, in France, joint ventures may be formed as Economic Interests Groupings (*groupement d'interet economique*), in Italy they may be formed as Consortia, etc. see Ashurst et al *supra* n. 158, pp. 28 - 29, 124 - 125 respectively.

¹⁹⁶Established according to EEC Regulation No. 213/85 of July 1985, more discussion on this is provided in chapter five *infra* pp. 200 -206.

practical sense, different legal vehicles or structures for joint ventures, should be seen as a chain or a web, connecting different interdependent corporate relationships. On the looser side of the chain, there are contractual joint ventures, on the more complex side of the chain, there are corporate joint ventures. Beyond corporate joint ventures corporate relationships take either a merger or a take-over form. The latter two are not the subject of our study. Joint venture relationships are summarised in Figure 2.1 below.

This chapter has given a general picture of the joint venture phenomenon. This helps to identify and isolate from other types of joint ventures, the joint venture company which is the subject of our study. Further, the chapter has made an analysis of the developing countries' economic, political and legal environment in which joint venture companies are established and operated. The economic, political and legal factors are likely to affect the nature of the law relevant to joint venture companies as will be discussed in the fourth chapter (at the national level) and in the fifth chapter (at the international or regional level). More importantly however, the chapter has specified the main argument of our thesis that: for company law adequately to provide for the formation and operation of joint venture companies, it should reflect the co-operative relations of the parties both theoretically and practically. The next chapter investigates corporate theoretical developments to this end. The legal provisions in company law which aim at providing for and maintaining the practical aspects of co-operation in the joint venture company are analysed in the fourth and fifth chapters.

Figure 2.1 **Legal Forms of Joint Ventures.**

THE FORM OF JOINT VENTURE	OBJECTIVES SPECIFIED IN THE JOINT VENTURE AGREEMENT(S).	THE LEGAL VEHICLE OR STRUCTURE FOR THE JOINT VENTURE.
<i>Contractual joint venture or Joint Venture Operating Agreements (JOA).</i>	<ol style="list-style-type: none"> 1. Production, and buy-back agreements. 2. Consultancy and management Agreements 3. Research/exploration Agreements. 	Although the legal vehicle for this structure is contract law, contractual joint ventures need an operator and management committee. Thus, classical contract law may not be adequate.
<i>Partnership Joint Ventures</i>	<ol style="list-style-type: none"> 1. Non-equity co-operative agreements. 2. Assembly and production agreements. 3. R&D agreements. <p>In these agreements parties start a firm to run their business.</p>	Partnership Law. But because joint venture partnerships involve companies as partners, this law may not be adequate. Mutual Trust and Confidence is required in these ventures.
<i>EEIG Joint Ventures.</i>	Formed by contract of formation, according to the EEC Regulation, to facilitate parent companies business.	The European Economic Interest Group EEC, Regulation No. 213/85 of 1985.
<i>Joint Venture Companies or Equity Joint Ventures.</i>	<ol style="list-style-type: none"> 1. Market entry agreements. 2. Loan Capital Agreements. 3. Management and Technical services Agreements. 4. Buy-back Agreements. 	The legal vehicle for this structure is the company. Parties have to obey, apart from their agreements, the requirements of company laws. For example, they have to have Memorandum and Articles of Association, for purposes of registering their joint venture company, etc.
<i>Mergers and take-overs</i>		

CHAPTER THREE

THE LEGAL THEORY OF THE JOINT VENTURE COMPANY.

3:1. INTRODUCTION.

The inquiry into the legal theory of the joint venture company is necessary to remove the confusion which surrounds the joint venture phenomenon. Until recently it was generally accepted that joint ventures may be formed as mere contracts, as partnerships or as companies¹. This position is increasingly being questioned in the Anglo-American business jurisprudence, mainly because there is neither statute nor case law which clarifies the position. Amidst this dilemma a group of commentators has emerged, arguing that joint ventures are different structures altogether from partnerships or companies². While the pre-occupation of this group is centred on trying to show the difference between partnerships and joint ventures, because both are unincorporated structures, they all agree that joint ventures cannot be classed as incorporated business structures like companies. Mildwaters³ for example, argues that:

'An examination of what is called incorporated joint venture reveals that, stripped to its bare essentials it is nothing rather than a company usually in the form of a limited liability public or private company.... Why not call what is referred to as an incorporated joint venture what is really is, that is, a company? It is submitted that it is a misnomer to use the term "joint venture" in relation to a company'.

To this group the joint venture is a relationship other than an incorporated organisation, otherwise it will be called a company, or a subsidiary company of its parents. Further, this group argues that the rules of law governing the joint venture are not to be found in legislation ("as none of the legal systems of the major western industrial nations address themselves specifically to joint

¹Ashurst Morris Crisps et al, Joint ventures in Europe, (1991) London: Butterworths; Linklaters & Pains, Joint Ventures (1990), London: Longman, pp. 1 - 11; Stedman and Johnes, Shareholders Agreements, (1990), London: Longman, pp. 172 - 214; Herzfeld Edgar, Joint Ventures, (1983), Bristol: Jordans and Sons Ltd. pp.35 - 39.

²Mildwaters, The Joint Operating Agreements: A Consideration of Legal Aspects, (1990), Ph.D. Thesis, University of Dundee, pp. 16 -17; Bean, Fiduciary Duties and Joint Ventures: The Joint Operating Agreement, (1992), Ph.D. Thesis, Cambridge University; O'Regan P.W and Taylor T.W, 'Joint Ventures and Operating Agreements', 14 VUWLR (1984), 85; Ongley Sarah 'Joint Ventures and Fiduciary Obligations' 22 VUWLR, (1992), 265; McPherson B. C, "Joint Ventures as a Separate Concept", in Finn P.D (Ed.) Equity and Commercial Relationships, (1987), Sydney: The Law Book Company Ltd. Ch. 6 pp. 19 - 36.

³Ibid., at p. 16.

ventures"⁴). However, the group accepts that joint venture law has been developed elsewhere, particularly in several former communist countries, including China.

Our study is of the view that, while these arguments may be true, they are overstated in the sense that they do not prove the non-existence of incorporated joint ventures. Incorporation does not eliminate the joint venture status if after incorporation, the relationship still reflects the essential elements of the joint venture⁵. The act of incorporation has the effect that the joint venture relationship which is essentially co-operative, operates through the corporate legal vehicle. It is in this sense that it is apposite to refer to all incorporated joint ventures as joint venture companies. This is also the case in countries like China which are alleged to have established separate joint venture laws. The joint venture laws of these countries provide for the formation of equity or corporate joint ventures⁶. As such, the question confronting us is whether, given present Anglo-American legal theory and company statutes, the important elements of the joint venture can be maintained in the corporate form after the incorporation of the joint venture relationship. To try to answer this question is the main concern of this thesis.

A joint venture corporation, like any other corporation, has its "personal law" through which it comes into existence, operates and comes to an end. That law determines the nature of the relationship among its members (*inter-se*), with its creditors and with others. Joint venture companies, however, have some characteristics or elements which may be different from those of other companies. In the following part we shall try to determine a legal theory which contains and regularises joint venture corporations in company law.

⁴Ibid., at p. 16.

⁵In support of this view there are two lines of argument. One believes that a joint venture can be formed as a company provided the elements necessary for its formation are not affected by company law. This includes writers who are cited in fn. 1 *supra*. In particular, Herzfeld who at p. 3 cites other writers who contend that the formation of a corporation will not prevent the survival of the joint venture nor relieve the venturers of their attendant liability; See also Demsbach, J.J, "Surviving Joint Venture Agreements after Incorporation" (Case Note) in 3 University of California Los Angeles Law Review, (1953) 94ff.; The other line of argument contends that joint venture companies are in essence partnership-like organisations. It is because of this fact that joint venture elements (or partnership elements) subsist even after incorporation. According to McPherson *supra* n. 3 at p. 29: "...a company which is created on the basis of mutuality of interests, mutual confidence and trust "may be viewed as an incorporated joint venture as readily as an incorporated partnership". Thus, where companies are created based on joint venture elements analogy should be made to equate them to partnerships. See for example, Re Yenidje Tobacco Co. [1916] 2 Ch. 426; Ebrahimi V Westbourne Galleries Ltd and other [1973] AC 360 and cases cited therein; See also Prentice D.D, "Winding up on the Just and Equitable Ground: The Partnership Analogy", 89 L.Q.R (1973) 107.

⁶On China's Joint Venture Laws see for example, Vaughan David, Ductzak Sundra and Snell Colin (Eds.), The EC and China, (1993), London: Butterworths, Ch. 4 pp. 120 - 121; Morser J. Michael (Ed.), Foreign Investment and the Law in the Peoples Republic of China, (1987), Hong-Kong: Oxford University Press. However, since this study is concerned with the company law of the countries which follow the Anglo-American and Commonwealth legal systems, the Chinese joint venture law will not be pursued further.

To determine which corporation theory is best suited to joint venture companies it is important to consider why and how the joint venture company, despite having the characteristics or elements of risk sharing, joint control, complementarity and interdependence should be called a company. In other words, the theory must be able to explain the fact that joint venture corporate actors (shareholders, managers, employees, etc.) are interdependent *qua* the joint venture, but as far as their parent corporations are concerned they remain independent. Thus, the theory must show both the "competitiveness" and the "co-operativeness" of members with the joint venture company. For the purposes of this chapter two major theories will be the centre of our inquiry, namely: *the entity theory and the aggregate or "nexus of contracts" theory*.

3:2. THE ENTITY THEORIES.

Generally the purpose of the entity theories is to attempt to give to the corporation a 'personality' analogous to that of a human being. Personification is very important to enable laws and states to deal with organised business entities like corporations⁷. It serves both corporate law and economic reality purposes. In particular, it implies a single and unitary source of control, it helps the company to operate as an autonomous creative self-directed economic being, and finally, personification captures rights for corporations thereby protecting them from the state and other individuals⁸.

In English law, the separate legal personality concept of a corporation was firmly established in *Salomon V Salomon & Co. Ltd*⁹, that:

'The company is at law a different person altogether from the subscribers to the memorandum and, although it may be that after incorporation, the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee of them'.

From this statement two competing approaches were brought forward to attempt to explain the nature of the corporation as a separate legal entity. One asserting that although the company is a separate legal entity, its personality is artificial, created by the state or law. This approach is widely termed as *the artificial entity* theory. The other, the *natural entity* approach, contends that the corporate entity is natural, it exists in reality. The state does not create corporate entities but it is forced to recognise them as it recognises human beings.

⁷This is why sometimes entity theories are known as *separate persona* theories, see Dias R.W, *Jurisprudence*, (5th edn), (1985), London: Butterworths, Ch. 12, pp. 265 - 269; Gregory Mark, 'The Personification of Business Corporations in American Law' *54 U.Ch.L.Rev* (1987), 1441; Wolf M. 'On the Nature of Legal Persons' *5 L.Q.Rev.* (1938), 495; Dawey J. 'The Historical Background of Corporate Legal Personality', *35 Yale L.J.* (1926), 655; Note, 'The Constitutional Rights of Corporate Persons', *91 Yale L.J* (1982) 1641, 1648.

⁸Mark *ibid.* at p. 1443.

⁹[1897] AC 22 H.L, at p. 51, per Lord Macnaghten.

3:2:1. The Artificial Entity Theory

This theory depends upon two interrelated but analytically distinguishable propositions: first, that the corporation is an artificial entity, and second, that the corporation exists only through the grant of incorporation from the Sovereign. The first proposition deals with an individualist conception of the use of property of the corporation while the second deals with the state's relationship to its citizens.

The first is based on the belief that private property is an individual right: an individual would not manage the property of others with the same interest with which he cares for his own¹⁰. Thus, rather than extinguishing individual interests the entity is created to promote them. It was from this understanding the notion 'artificial' was used. The corporate entity is a matter of necessity but individual interests must be preserved in the corporate charter. The charter should restrict collectivism because the chartered property naturally remains the property of individuals. As regards this Daniel Webster noted:

'And does the granting of a charter which is only done to perpetuate the trust in a more convenient manner make any difference?...The very object sought in the obtaining such a charter, and in giving property to such a corporation, is to make and keep it private property, and to cloth it with all the security and inviolability of private property. The intent is that there shall be a legal private ownership'¹¹.

In order to protect the individual interests of the corporators it was necessary that the corporation and its members stick to what the individual shareholders had agreed on in the charter. Commentators have pointed out that the doctrine of *ultra-vires* is an expression of the artificial entity proposition¹². If the corporation is created as a matter of necessity to protect individual rights, then the argument goes that the power of perpetual succession, the capacity to sue and be

¹⁰Theories of private property originate from the writings of classical philosophers like John Locke, Hugo Grotius, Samuel Puffendorf and others. However, these were much more interested in the general conception of property. For example, Locke was quoted saying: 'I shall endeavour to shew how men might come to have property in several parts of that God gave to mankind in common' (Quoted by James Tully in John Locke: A Discourse on Property, (1980), Cambridge: Cambridge University Press at p. 95). It was Adam Smith in his concepts of free enterprise and free competition who expanded/narrowed the individual conception of property, in one of his treatises he said: 'Every man... is much more deeply interested in what immediately concerns himself, than in what concerns any other man', (Adam Smith, The Wealth of Nations, Books I - III, edited by Andrew Skinner (1986), London: Penguin Books p. 21). For a critical analysis of Adam Smith's concepts of free enterprise and free competition, as they apply to corporations see Berle A. & Means G.C., The Modern Corporation and Private Property, (1968), New York: The MacMillan Company, pp. 349ff.

¹¹Quoted by Mark, *supra* n.7 at p. 1449, original reference omitted.

¹²Bottomley Stephen, 'Taking Corporations Seriously: Some Consideration for Corporate Regulation', 19 Federal Law Journal, (1991), 203, at p. 208; See also the dicta by Lord Hatterly in Ashbury Railway Carriage & Iron Co. V Riche, [1874 -80] ALL ER Rep. Ext 2219, at p. 2230 where he stated *inter alia* that '...the legislature has said, you may meet together and form yourself into a company, but in doing that you must tell who may be disposed to deal with you the objects for which you have been associated', more discussion on this doctrine as far as joint venture companies are concerned is provided in the next chapter.

sued, the capacity to own property or shares in other corporations become a convenient but 'unusual' way of holding property¹³. However, this conclusion leaves many questions unanswered. For example, why should an individual find it necessary or convenient to join others rather than becoming a sole trader? One inevitable consequence of business associations is the creation of another category of interests - group interests¹⁴. Since the corporation is created to further individual interests there is a possibility that individual interests may conflict with group interests. Another possibility is that if individuals are protected at the expense of group interests it may lead to the break up of the group. In order to protect individual interests therefore, the corporation has to be protected by law (state). Paradoxically, it is by protecting the corporate entity, that individual interests as well as group interests can be protected within the corporation. This brings us to the second proposition of the artificial entity theory.

According to this proposition corporate personality is a grant from the sovereign. The corporation was regarded as a concession granted by the state¹⁵. The concession history goes back to the Middle Ages when the Church had control over political power, before the emergence of states. According to Pollock and Maitland¹⁶ it was Pope Innocent IV who introduced the notion of grant or concession. In the Pope's view the church conceded to individuals the power to organise institutions inferior to the Church. These institutions existed by the grace of the church and were therefore fictitious, devoid of any authority save for that derived from the church¹⁷. As the state began to displace the church the power of the grant was appropriated by states. Each state used this power to bring under its authority guilds and other organisations which competed for the loyalties of its citizenry¹⁸. However, as we have seen above the need for the state to maintain control over corporations was differently justified: it stemmed from the fear that organisations would become more powerful than the state and would undermine it or reign tyrannically over individuals¹⁹. By taking such a view, the artificial entity theory emphasised the *quid pro quo*. That

¹³Posner Richard, The Economic Analysis of Law, (3rd edn), Boston: Little Brown & Co. Ltd. pp. 367 - 368.

¹⁴Group interests include the interests of all who participate in the formation and operation of the company: shareholders, managers and employees, but may include creditors, consumers and the community at large. See Berle and Means supra n. 10 Ch. 4 where they discuss conflicts of interests between shareholders and managers; Coffee J. C 'Shareholders Versus Managers: The Strain in the Corporate Web', 85 Mic.L.Rev., (1985), 1.

¹⁵Bottomley supra n. 12 p. 206.

¹⁶Pollock Frederic and Maitland William, The History of English Law, (1923), (2nd edn), London: Cambridge University Press; Dawey, supra n. 7 pp. 666 - 667.

¹⁷Dawey ibid. at p. 665 he discusses institutions like *collegium*, *universitas* or *capitulum* as incorporeal and that *soulessrei fictae*, could be punished or be guilty of deceit.

¹⁸Mark G. supra n. 7 at p. 1469; Note 91Yale L. J supra n. 7 at p.1645 at footnote 22 the case of Duvergja v Fellons (34 Rep. 578 K.B 1830) is referred where the judge said *inter alia* that: 'Those who without the sanction of the Legislature, presume to act as a corporation, are guilty of a contempt of the King, by usurping on His prerogatives'.

¹⁹Coates John IV, 'State Take-over Statutes and Corporate Theory: The Revival of the Old Debate' 64 NY.U.L.Rev. (1989), 806, 812-813.

the state agrees to grant legal corporate status, and the important privileges it entails for a *quid pro quo*. As a price for the grant, incorporators had to reciprocate, to respect group interests and the interests of the public at large. Thus, the concession approach expands the artificial theory by explaining the role of the state of protecting the interests of the whole community as well as individual interests.

One effect of the concession theory for developing countries was that the vision of a corporate person with powers limited by the state was filtered through Common Law traditions to govern the legal status of corporations in the English colonies. This concept has survived for the modern transnational corporate business in host countries in the form of incorporation theory²⁰.

The dual role of the state of protecting individual interests as well as collective interests in the corporation, has its own effects on the policy of free trade and private property. The state may fail to balance these interests and may enact laws which restrict individual interests. This may induce other theories to develop in order to protect individual interests and minimise state intervention.

3:2:2. The Real Entity Theory.

This theory asserts that the law does not create its subjects, rather, it is forced to recognise the extra-legal existence of certain persons - some natural, others not²¹. The corporation as a legal person is real and not fictitious because:

'When a body of twenty, or two hundred thousand men bind themselves together in a particular way for some common purposes, they create a body which by no fiction of law but the very nature of things, differ from the individuals of whom it is composed'²².

The corporation's existence depends on the functioning of the whole corporate system²³. For that reason a corporation is distinct from its members²⁴. By asserting that a corporation is not a creature of law, this theory sought the reasons for the existence of the corporation from market forces. This is seen by Coates as an attempt to parallel different theories of the firm which were being developed by economists to explain the existence of a corporation as a specialised form of

²⁰Note, 91 Yale L.J. supra n. 7 at p. 1646; Mukoyogo M.C., Conflict of Corporation Laws: The Personal Law of Juridical Persons: A case for Tanzania, (1983) Ph.D. Diss. University of Konstanz, Ch. III, pp. 27 - 64.

²¹Note, 91 Yale L.J. supra n. 7 at p. 1649; Pollock and Maitland supra n. 16 pp. 461 - 475.

²²Dawey supra n. 7 at p. 673.

²³According to Berle: 'even if all corporate laws were abolished....In vain some lawyers complain that the Directors could no longer fix policy, or the president gives orders....The huge machines would keep right on rolling. This is an essence of the existence of an institution, and not of a legalist creation', from Berle A, The Twentieth Century Capitalist Revolution, (1954), New York, Harcourt: Brace & World Inc., pp. 18 - 19.

²⁴Laski, 'The Personality of Associations' 29 Harv.L.Rev., (1928), 404, 415.

business enterprise²⁵.

The real entity theory contributed two important developments in the history of corporations. Firstly, it started the debate on ownership and control of the corporation, and secondly, it was the basis for a sharp distinction between private and public corporations.

The issue of control came from the assumption that a corporation was a real or an organic entity like an individual. In economic terms a corporation was regarded as 'an economical man', a function of production or a living organism, being controlled by market forces. Therefore there was a need to make this entity speak and act in law like any other individual. The problem was who should be the mouthpiece of the corporation. As Sir Paul Vinogradoff posed it:

'How is the law to deal with such super-individual undertakings? The usual expedient is to assimilate to live persons. We assign them a will i.e., the faculty of taking resolves in the brain and nerves, in shape of institutions and agents; a capacity for the promotion and defence of interests by holding property, performing acts and exercising right of action in courts'²⁶.

Because skill was needed for the corporation to be organised and because its shareholders were becoming increasingly dispersed, it was further argued that continuing joint control of the corporation by all corporators was impossible. Therefore, corporators had to delegate their powers of control to the shareholder with the majority shares who in turn delegated a part of it to his representatives, the management²⁷. Practical experience fixed the corporate 'mind' and 'will' in the management hierarchy. The management was to be regarded as the instrument of the corporation, its mouthpiece.

According to the real entity theory the corporation was not a creature of the state. Therefore, the state is not supposed to interfere in the private arrangements of its citizens among whom the corporation was classified. Analysts have argued that this is the essence of the difference between private and public corporations²⁸. Private corporations were created to protect individual interests, whereas public corporations were created to serve collective or community interests. Thus, while the government can regulate the formation and operation of public enterprises,

²⁵This was the time when R. Coase wrote 'The nature of the Firm' which as we shall see shortly was the basis of the aggregate of contracts theory. See Coates supra n 19, at p. 829, at footnote 155 he distinguishes the 'corporation' from the 'firm' by calling a corporation a legal concept and a firm, an economic concept. But Posner supra n. 13, at p. 368. sees a firm as a general concept and a corporation as a 'method' encountered in the rising of capital, because of the latter's perpetual existence and limited liability rights.

²⁶Quoted by Mark G. supra n. 7 at p. 1475.

²⁷Berle and Means supra n. 10, pp. 349ff.

²⁸Bottomley supra n. 12 pp. 205 - 206; Wolf supra n. 7; Kennedy D 'The Stages of Private/Public Distinction', 130 U.Penn.L.Rev. (1982), 1349.

private enterprises should be left to be regulated by market forces²⁹. Although the distinction between private and public corporations has been maintained in legal theory and company law statutes, critical analysts have discovered that the distinction between public and private is continuously becoming indistinguishable in reality³⁰.

As the distinction between private and public corporations is blurred, critics of the entity theory gain strength. They maintain that the concept of a corporate entity is a blanket either hiding inappropriate reasoning or justifying an improper decision:

'To insist that because it has been decided that a corporation is a legal person for some purpose it must therefore be a legal person for all purposes, or to insist that because it has been decided that a partnership is not a legal person for some purposes, it cannot therefore be so for any purposes, is to make of both corporate personality and partnership personality a master rather than a servant and to decide legal questions on irrelevant considerations without inquiry into their merits³¹.

It has been argued that the problem of drawing a line between a partnership and a corporation, or between a private and a public corporation stems from the individual conception of property. Theorists of the real entity theory being guided by the individualist conception of a corporation did not like to analyse the corporation from the point of view of the relationships of its members operating in a single unit of production. Berle and Means had earlier pointed out that a corporation represented group activities, the co-ordination of different steps of production, and the extreme division of labour. This necessarily implied not only individualism but also co-operation³². The conjuring of a corporation in the form of an individual to govern those composing it becomes increasingly difficult with the growth of big corporations comprised of different individuals with conflicting interests. This situation renders the management group, which is supposed to represent the interests of the corporation, legally unmanageable. Marks concludes that:

'Private property rights had been transferred to associations, associations had themselves become politically legitimate, and the combination had helped foster modern political economy. The corporation, once the derivative tool of the state, had become its rival, and the success of autonomous corporate management turned the basis for belief in an individualist conception of property on its head. The protests of modern legists notwithstanding, the business corporation had become the quintessential economic man³³.

²⁹Graham Tomson, 'The Firm as a Dispersed Social Agency' 11 J.Econ.&Soc., (1982) p. 233.

³⁰Bottomley supra n. 12 pp. 205 - 206; Kennedy D. supra n. 28; Dalton C. 'An Essay in the Deconstruction of Contract Doctrine' 94 Yale L.J (1985), 1010 at p. 1013.

³¹Mark G. supra n. 7 at p. 1479; See also Note, 'Personality' 37 Yale L.J (1928), 383 at p. 398.

³²Berle and Means supra n. 10 at p. 349.

³³Supra n. 7 at pp. 1482 - 1483.

3:2:3 The Entity Theories and the Joint venture company.

Because they pay too much attention to the "entity", entity theories do not reflect the important elements necessary for the joint venture company. Co-operative elements in private business associations are regarded as the concern of close or family commercial arrangements such as partnerships which have nothing to do with corporate entities. However, the entity theories overlook the fact that while state action is in some cases necessary, the process of forming, operating, organising and restructuring the company, is, on the contrary, the result of private bargaining and decisions by individual parties. It is through this process that parties discover the nature and extent of their interests (whether complementary or not, permanent or temporary, etc.), and decide on the type, form and structure which their business relationship may take. The latter essentials are totally ignored by the entity theories. As such, these theories fail to explain modern corporate problems, such as the relationship between two interdependent companies, between parent and subsidiary companies, between shareholders *inter-se*, and how directors should balance the interests of the outside actors with those of shareholders, workers, etc.³⁴. It is the discussion of these issues which are relevant to the elements of joint ventures, and which may bring joint venture phenomena into the company legal theory.

3:3. THE AGGREGATE OF CONTRACTS THEORY.

According to the aggregate of contracts theory, the corporation is a legal fiction that serves as a nexus of a set of contracting relations among individual factors of production³⁵. The theory looks through the corporation and sees only individuals in their different contractual relationships. It dissolves the corporate entity into its particularities - conjuring up an image of a 'web' or a 'nexus of contracts'³⁶. It claims to remove the dilemma which has been facing corporate theorists since the Medieval era when the notion of corporation was first understood. The aggregate theory was developed then to oppose the artificial entity theory. To the classical aggregate theorists, to allow the state to sanction the formation and the regulation of corporate operations would result in the state saturating private corporations with 'public interests'. They suggested that the proper way to

³⁴Dias supra n. 7 at p. 265.

³⁵Bratton W. 'The Nexus of Contracts Corporations: A Critical Appraisal' 75 Corn.L.Rev. (1989), 407, at p. 415; Posner Richard supra n. 13, Ch. 14; Coates supra n. 19; Symposium articles in 89 Colum.L.Rev (1989), 141ff; Cheug, 'The Contractual Nature of the Firm', 26 J.L. & Econ. (1983), 1; Klein 'The Modern Business Organisations: Bargaining Under Constrains' 91 Yale L.J. (1982), 1524; Ayres and Gartner Robert, 'Filling Gaps in Incomplete Contracts: An Economic Analysis of Default Rules' 99 Yale L.J. (1987), 87; Coffee J.C., 'Shareholders Versus Managers: The Strain in the Corporate Web' 85 Mich.L.Rev. (1985), 1.

³⁶Coates supra n. 19, at p. 815.

think of corporations was that they were similar to partnerships³⁷. The role of the state was to give the relationships a convenient form and then to enforce them³⁸. The idea of a corporation as an aggregate of contracts did not gain much support during the 19th century and the early decades of the 20th century because of the dominance of entity theories. The revival of the aggregate theory has been sparked by the 'Law and Economics' school³⁹. The school starts from the economic assumption that man is a rational maximizer of his own interests. Any rational maximizer of self wealth will try to avoid any impediments which will give him less valuable resources. The laws of demand and supply suggest that resources should be allocated to those who can utilise them best. When shareholders decide to co-operate in a company, they do so because they want to maximise their wealth or income⁴⁰. The company form is used because of transaction costs in making and maintaining separate contracts⁴¹. Thus, the contracting process in the corporation should be premised on competition between shareholders and different agents in the corporation namely, management, employees, etc., not on co-operation. This school argues that because shareholders are residual risk bearers in the company, their arrangements with other corporate actors should aim first and foremost, at promoting or protecting shareholders' interests.⁴²

3:3:1 *The role of company law and the State.*

Since shareholders are the maximizers of their own wealth, then according to the aggregate theory they must be free to choose the terms and conditions of their contracts and the state should not regulate their private ordering. Therefore, they should be left free to contract on terms which they consider efficient and to contract around any terms provided by the law if they consider them inefficient⁴³. Company law is regarded as one of the specialised forms of law of contract⁴⁴. As such its role is to provide a default contract for shareholders to use if they do not want to write their own⁴⁵. In other words, shareholders' relations, *inter-se* and with other actors,

³⁷Note, 91 Yale L.J supra n. 7, at p 817.

³⁸Coates, supra n. 19 at p. 815.

³⁹Coates *ibid.* pp. 817 - 825; Posner supra n. 13 Ch 14.

⁴⁰Bratton supra n. 35 at p. 417; Posner *Ibid.* at pp. 369 -372.

⁴¹The aggregate of contracts theorists use Ronald Coase's article: 'The Nature of the Firm' to support this argument, see Easternbrook F. H and Fischel, D.R, 'The Corporate Contract', 89 Colum.L.Rev., (1989), 1416, at p. 1417.; For the original article of Coase see 4 ECONOMICA, (1937), 386.

⁴²See for example, Henry Hansmann, "Ownership of the Firm", in Coleman Jules and Lange Jeffrey (Eds.), Law and Economics, Vol. II, (1992) Aldershot: Dartmouth, 101 at pp. 103 -130; See also Henry Hansmann, "Viability of Worker Ownership: An Economic Perspective on Political Structure of the Firm", in Aoki, et al (Eds.) (1990), The Firm as a Nexus of Treaties, London: Sage Publications.

⁴³Coffee John, 'The Mandatory/Enabling Balance in Corporate Laws: An Essay on the Judicial Role' 89 Colum. L. Rev., (1989), 1678; Posner supra n. 13 at p. 372.

⁴⁴Posner supra n. 13, pp. 369 -372.

⁴⁵Easternbrook, H. and Fischel D., The Economic Structure of Law, (1991), London: Harvard University Press, at p. 34.

should first and foremost be regulated by market forces. Rules of law should operate only to perfect the market and make it run more smoothly. Professor Easterbrook says that: 'there are lots of terms (in corporate law) such as rules for voting, establishing quorums, and so on that every one will want to adopt. Corporate codes and existing judicial decisions supply these terms free to every corporation'⁴⁶.

After promoting shareholders interests above the interests of other constituencies, the theory turns to explain the concept of ownership and control. The explanation of how corporations are used by the state to protect the interests of other constituencies outside the corporation is tactically avoided. It is argued that when resources are allocated to the best users and make them better off, the whole society is made better off if the allocation does not make one of the parties worse off, according to the Pareto superiority assumptions⁴⁷.

3:3:2 The Agency Costs.

Since the times of Berle the discussion of the corporate doctrine and policy has been based on the legitimacy of management control⁴⁸. Company law placed the management in the trust-trustee and agent-principal relationships *vis-à-vis* the corporation. Critics of this formulation pointed out that it made the management accountable to nobody, since the corporation does not exist in reality⁴⁹. Further, that management and law gave less importance to shareholders interests. Aggregate of contracts theorists argue that although shareholders establish the corporation in order to avoid transaction costs, the corporation form also has its own costs⁵⁰. Shareholders have to contract with other persons who are better informed and have skills and know-how to manage and

⁴⁶Supra n. 41 at p. 1444.

⁴⁷Pareto superiority is an economic principle developed by Pareto asserting that one allocation of resources is superior than the other if at least one person is better off under the first than under the second, and no one is worse off. See Posner Richard, The Economics of Justice, (1981), Cambridge: Harvard University Press, at p. 88; However, it is very difficult to see how this principle can apply in law generally and in company law in particular. This is because law deals *inter alia*, with wealth distribution issues. In this respect while each shareholder may be responsible for judgement of his own welfare, socio-economic constraints or the economic environment in which he operates have to be put into consideration. Inevitably, questions whether wealth has been distributed fairly in a given economic environment have to be answered. See the discussion on this by Calabresi Guido, "The Pointlessness of Pareto: Carrying Coase Further", 100 Yale L.J (1991) 1211, at pp. 1227 - 1228; See also Coleman L. Jules, 'Efficiency, Utility and Wealth Maximisation', in Coleman Jules and Lange Jeffrey (Eds.), Law and Economics, vol II, (1992), Aldershot: Dartmouth, 509, at pp. 512 - 517; Dworkin M. Ronald, 'Is Wealth a Value?', in Coleman and Lange *loc cit.* p. 191 at pp. 193 - 194.

⁴⁸Farrar H. 'Ownership and Control of Listed Public Companies: Revising or Rejecting the Concept of Control' in Pettet B.K (Ed.) Company in Change: Current Legal Problems, (1987), London: Steven and Sons, at p. 39; Stokes Mary, 'Company Law and Legal Theory' in Twining W. (Ed.), Legal Theory and Common Law (1986), New York: Blackwell Inc. pp. 155 - 180; Bratton supra n. 35, at p. 413..

⁴⁹Bratton *ibid.* at p. 413.

⁵⁰Easterbrook and Fischel supra n.41, pp. 1416 - 1425.

organise production. Since rational managers are also maximizers of their self wealth, they may utilise their positions to avoid performing the duties promised in contracts, and use shareholders wealth for their own benefits. This is what is called "shirking"⁵¹. Rational shareholders are aware of shirking and charge it against the price of managers' contracts. Hence, rational managers will reduce agency costs so that they can keep jobs. Otherwise, they will be replaced, given the competitive markets for managers⁵².

The separation of ownership and control which is the centre of discussion in the entity theory, (which gave the power to the management to control the corporate entity) almost disappears under the aggregate theory. Ownership as well as the "entity" become irrelevant. The corporation presents a "web" or a series of contracts between shareholders *inter-se*, between shareholders and the management, between management and employees, and between management and third parties⁵³.

3:3:3. *The Aggregate Of Contracts Theory and The Joint Venture Company.*

By trying to analyse the corporation on the basis of the relationships of those who compose it, the aggregate of contracts theorists have taken us a step forward towards ascertaining whether the joint venture company may be accommodated in the legal theory of the company. However, an analysis of the arguments of these theorists reveals that the important elements for the joint venture have not been adequately discussed. This is not because these elements cannot be accommodated in corporate theory, but like the entity theories, the aggregate of contracts theory is essentially individualistic. As such, the only relationship discussed, namely between shareholders and managers is not premised on co-operation, but on competition. Thus, although it is argued that corporations should not be regarded as something more than partnerships, elements which feature in partnerships, such as mutuality of interests, shared control and shared profits, and their applicability to the relationships between shareholders *inter-se* and between shareholders and managers, are not discussed. Examples of this inadequacy are analysed below.

I. Investor - Management Relationship.

The assertion by the aggregate of contracts theory that the relationship between management and investors is contractual, leaves a number of problems unresolved. Under the classical contractual

⁵¹Bratton supra n. 35, at p. 417.

⁵²Posner supra n. 13, at p. 383. Of course, this is subject to other internal actions which may be introduced to minimise shirking. For example, providing incentives to managers in terms of bonus, shares, etc.

⁵³Brudney Victor, 'Corporate Governance, Agency Costs and the Rhetoric of Contracts', 85 Colum.L.Rev. (1985) 1403.

model, on which it is based, it is assumed that the relationship between managers and investors is entered into voluntarily and knowingly. The assumption of voluntariness becomes questionable when one considers the fact that in modern business associations shareholders lack the necessary knowledge on proper or efficient business organisation. Moreover, in most modern corporations, shareholders are too dispersed to be able to monitor the performance of managers in the manner they choose⁵⁴. Managers, because they are better positioned in this relationship, if left to be regulated by contractual relationship alone may be tempted to utilise their managerial skills to shirk, unnoticed by either shareholders or market forces⁵⁵. Indeed, this may give them more discretion than company laws would provide.

Although the hiring and firing of the management by shareholders is considered as one way of controlling the management, the present procedure of selecting the management raises doubts whether this mechanism can work. According to the current procedure⁵⁶, the management is selected by directors who act as representatives of shareholders. Shareholders therefore depend on directors to hire and renew management contracts. This also proves that shareholders have little involvement in the selection of the management. The board of directors is usually dominated by executive directors who determine the terms and conditions of management employment. Shareholders rarely negotiate with the management on these terms⁵⁷.

When one considers the fact that executive directors are always delegated by shareholders to vote on their behalf in the general meetings as their proxies, it becomes clear that it is always the executive directors who make decisions on the selection/termination of the management contracts. Executive directors are part and parcel of the management. Therefore, it is most likely that these directors will be on the side of the management when issues of termination of one or all of the management contracts are discussed. Moreover, the interests of shareholders may be conflicting and this situation may induce some of them to support the management⁵⁸.

Agency cost principles pose considerable doubt as to their ability to solve the problem of shareholders-management relationship. As seen above, according to agency principles, agency costs are inevitable consequences of the gains that come from delegating within the firm the

⁵⁴Brudney *ibid.* at p. 1406.

⁵⁵Clark C. Robert, 'Contracts Elites, and Traditions in the Making of Corporate Law' 89 Colum.L.Rev. (1989), 1703

⁵⁶Farrar H., Company Law, (1991), (3rd. edn.), Ch. 20 at p. 341; Tanzanian Companies Ordinance (Cap 212) ss 140 - 152, and Table A, First Sch. on the appointment of managers.

⁵⁷Brudney *supra* n. 53 at p. 1413; Note 'The Propriety of Judicial Defence to Corporate Board of Directors', 93 Harv.L.Rev. (1983), 1894.

⁵⁸Burton, 'Breach of Contract and Common Law Duty of Good Faith' 94 Harv.L.Rev. (1984), 369, at pp. 371 - 372.

performance of special tasks to persons who are best (or better) able to perform them, but who have interests that conflict with those of the delegator⁵⁹. This is a recognition that the self interest of the agent tends to induce behaviour that reduces the quality of its performance, i.e., shirking or the diversion of the principal's assets to itself. The aggregate theorists see this problem being solved by a charge by rational shareholders against these costs *ex-ante* on contract formation. This solution becomes doubtful when one considers that shareholders, given their lack of managerial skills, cannot know *ex-ante* what the managers should do. Brudney sums it up like this:

'...to analyse the relationship between investors and the management in terms of simple agency implies a control by investor over the management, and knowledge by the investors of the management behaviour, that would permit the possibility of *ex-ante* bargaining and of contemporaneous or *ex-ante* consent by investors to virtually everything management might do; and such an analysis also implies the actuality of consent to much that management does'⁶⁰.

Thus, the agency contract between shareholders and the management implies that shareholders have consented to the shirking and diversion of assets by the management. But this is not the case. Problems of shirking and asymmetric information present a greater difficulty which need new rules of bargaining and disclosure which may call for the intervention by external authorities to set the limits on terms within which parties can bargain for their private ordering, *ex-ante* and *ex-post*⁶¹. Shareholders cannot depend on the market to regulate the behaviour of the management because the 'hiring' of the management is done by executive directors who also belong to the management and provide managerial services as well. "When persons acting for the buyer are also the sellers of the managerial services, there is simply no market"⁶². If the market is there, it is the market which is already colluded by the management, hence, which disadvantages the investors⁶³.

In the final analysis, the contract model which assumes that each group of shareholders or managers is a knowledgeable consenting participant makes little difference to the Berle and Mean's analysis that management has a considerable control power with little accountability⁶⁴.

⁵⁹Fama and Jensen 'Separation of Ownership and Control' 26 J.L. & Econ., (1983) 301; Bratton *supra* n.35 at pp. 417 - 418.

⁶⁰*Supra* n 53. at p. 1430.

⁶¹According to Brudney, *ibid.* at p. 1431: 'Like the term 'contract' the agency concept rests on premises and consequences appropriate for one concept and is imported into a totally different context, one for which premises are inaccurate and consequences inappropriate'.

⁶²Brudney *ibid.* at p. 1421.

⁶³Gordon and Kornhauser, 'Efficient Markets, Costly Information, and Securities Research' 60 N.Y.U.L.Rev., (1986), 761, at p. 830.

⁶⁴*Supra* n. 10. There is an argument that the problem of management control can be solved by allowing institutions to own/buy shares in corporations. This view forgets the fact that managers as well as institutions can all behave opportunistically: 'The fact that institutions are also managed should not be overlooked' (Coffee

Unlike Berle and Means however, the aggregate theory seeks to legitimise this power.

II. Interests of other constituencies in the corporation.

The aggregate theory gives arguments on the relationship between shareholders and management as if these are the only constituencies of the corporation. It shows how the management should maximise the wealth of shareholders as if the corporate game involves only shareholders. Moreover, the theory paints a picture of a smooth relationship between shareholders, with no conflicting interests. This study contends that the corporation is a totality of constituencies with different interests, of which shareholders, managers, and employees are important integral parts. But the corporation also includes other constituencies such as creditors, consumers and the community at large⁶⁵. Each of these has an individual interest toward the corporation which may conflict with those of the others⁶⁶. When the corporation is seen as comprising long-term contracts between these different individuals, one realises that judicial involvement is an integral part of such contracting. The question which is not answered by the aggregate of contract theorists is how this diversity of interests can be accommodated in the corporate structure, without involving some elements of co-operation between the constituencies.

The aggregate of contracts theory is premised on protecting the interests of one constituency (shareholders), sometimes at the expenses of others. This may not be ideal for the joint venture company in which the interests of all the constituencies are complementary and therefore interdependent. Promoting the interests of shareholders alone does not reflect realities in modern corporations, including joint venture corporations. For example, doctrines which protect shareholders, supported by the aggregate of contract theory, like the doctrine of limited liability⁶⁷, become a mockery when applied to relationships between corporations⁶⁸. Relationships between parent and subsidiary companies, between interdependent companies, and between dominant and dependent companies which may result in the formation of a group of interests between these companies, and which may force/condition companies to operate as a single economic entity or enterprise, are not explained by the aggregate of contracts theory. Thus, the applicability of this theory to the joint venture company is highly doubtful.

John C. 'Liquidity Versus Control as a Corporate Monitor' 91 Colum.L.Rev., (1991) 1277, at p. 1367.)

⁶⁵Coffee supra n. 35 at p. 11; Williamson Oliver 'Corporate Governance' 93 Yale L.J (1984), 1197, at 1198 accepts that the aggregate of contracts theory lacks a framework which permits a detailed analysis of transactions among constituencies of the corporation.

⁶⁶Eisenberg A. Melvin, 'The Structure of Corporate Law' 89 Colum. L.Rev. (1989)1461. at p.1471

⁶⁷Easternbrook H. Frank and Fischel R. Daniel, 'Limited Liability and the Corporation' 52 U.Ch.L.Rev. (1985), 89 - 117.

⁶⁸Blumberg I. Phillip, The Multinational Challenge to Corporation Law, (1993), New York: Oxford University Press, at pp. 58 - 59.

3:4. TOWARDS A RELATIONAL BASED THEORY.

Ever since Hobbesian times, the puzzle of why individuals while struggling to pursue their individual interests, find themselves in co-operative economic organisations, has not been adequately answered⁶⁹. We have seen that the individual conception of the corporation can not eliminate co-operative elements. The corporation is comprised of different constituencies which have conflicting interests. These interests notwithstanding, a corporation continues to exist as a single economic unit. We submit that the contemporary corporate theory must be able to explain the presence of individual interests which do not simply co-exist, but also reflect elements of co-operation, essential for that co-existence. The complex co-existence of interests should be accepted as a starting point and the theory should go on to explain their interrelationships⁷⁰.

3:4:1 Developments in the Relational based Theory.

The study of different relations in the corporate firm was initiated by neo-classical micro-economists⁷¹, some lawyers⁷² and sociologists⁷³. All assert that the essence of the corporation cannot be studied by using market forces alone (external efficiency) but primarily by relationships between corporate actors (internal efficiency). It is the internal efficiency which enables the firm

⁶⁹In 1651 Thomas Hobbes asked: "Why do men co-operate with each other in the society? Why is there not a continuous war of everyone against everyone, as each individual pursues his own interests by whatever means including force, that are at hand?", Quoted by A. Strauss, Negotiation, (1978), San Francisco: Jessey Bass Publishers, at p. 24.

⁷⁰Bratton W, 'The Nexus of contracts Corporation: A Critical Appraisal', 74 Corn. L.Rev. (1989), 407, at p. 411.

⁷¹See for example, Winter, 'On Coase, Competence and Corporation', 4 J. of L. & Econ. (1979), 163; Williamson Oliver, 'Corporate Governance', 93 Yale L.J. (1984), 1197; Aoki Masahiko, 'Managerism Revisited in the light of Bargaining Game Theory', Int.J.of Ind. Org., (1983), 1 - 21; Aoki Mashiko, B. Gustafson and Williamson, Oliver (Eds) The Firm as a Nexus of Contracts, (1990), London: Sage Publications; Williamson Oliver E and Winter Sydney G. (Eds.), The Nature of the Firm: Origins, Evolution and Development, (1991) New York: Oxford University Press.

⁷²Eisenberg Malvin, The Structure of the Corporation, Boston: Littlebrown; Calabresi Guido, 'The Pointlessness of Pareto: Carrying Coase Further', 100 Yale L.J. (1991), 1211; MacNeil Ian, 'Economic Analysis of Contractual Relations: Its shortfalls and a Need for a Rich Classificatory Approach', 75 New South Wales Univ. L. Rev. (1990), 1018; MacNeil Ian, The New Social Contract: An Inquiry into Modern Contractual Relations, (1982), New Haven, London: Yale University Press; MacNeil Ian, 'Relational Contract: What We Do and Do Not Know', Wis. L.Rev. (1985), 483; MacNeil Ian, 'The Many Futures of Contracts', 47 S. Cal. Rev. (1974), 691; Drury R. R, 'The Relative Nature of a Shareholder's Right to Enforce the Company Contract', C.L.J [1986] 219.

⁷³Colman Andrew, "Experimental Games", in Colman Andrew (Ed.), Co-operation and Competition in Humans and Animals, (1982) Workington, England, Van Nostrand Reinhold (UK), Co. Ltd.; Hinde A. Robert and Grobel J. (Eds.), Co-operation and Pro-Social Behaviour, Cambridge: Cambridge University Press; Strauss Anselm, *supra* n 69.

to adjust itself to the market environment, given market imperfections⁷⁴. They generally recognise the existence of the corporation as an entity, comprised of long-term contracts, determining or specifying the relationship between different corporate actors⁷⁵. In a way, they attempt to reconcile the entity theory with the aggregate of contracts theory. The relational approach regards corporate actors as having both conflicting (individual) as well as co-operative elements. The self-interest of individual wealth maximisation is considered as the primary aim of each actor and to the extent that some individuals may be tempted to act opportunistically⁷⁶. Individuals have to engage themselves in contractual relations with others because of economic interdependence. Continuous contracting between the actors creates co-operative elements in the relationship. This contracting is no longer modelled on classical principles, because it is not discrete but relational, indicating that parties are interdependent and are continuously involved in negotiation to maintain it⁷⁷. Thus, interdependence between different participants in the corporation and continuous negotiation in and out of the corporation, become some of the necessary factors for relational contracting. Hence, the essence for the existence of a corporate firm.

I. The concept of Interdependence.

Interdependence is taken generally to mean a situation in which more than one agent is needed to cause a certain event or events to happen⁷⁸. In social and economic interactions, interdependence exists whenever one actor does not control entirely all the conditions necessary for the achievement of an action or for obtaining the outcome desired from the action. In other words, the ability of a single actor is limited because of either bounded rationality or lack of adequate assets or resource to be able to achieve the outcome on its own. Interdependence is categorised into two categories, namely: *outcome interdependence and behaviour or input interdependence*⁷⁹.

Outcome interdependence takes place in situations where the outcome achieved by one party is

⁷⁴MacNeil (1990) supra n. 72; Aoki Masahiko supra n. 71 at p. 57; Spence, 'The Economics of International Organisations', 6 *Bell J. of Econ.*, (1975), 163, at p. 172 he argues that markets may collapse to some extent, but operation of the firm with its management in resources allocation continues.

⁷⁵Bratton supra n. 70 at p. 421.

⁷⁶MacNeil (1990) supra n. 72, at pp. 1023 - 1024; Williamson Oliver, *Economic Institutions of Capitalism*, (1985), New York; Free Press, chapter 2, pp. 47 - 49.

⁷⁷MacNeil supra n. 76, at p. 30 he says: 'The heightened awareness of conflict of interests found in the large contractual relations might on first glance be accepted to turn them into a group of discrete transactions....But many of the factors found in the relation - for example, the need of future co-operation - create a high level of interdependence in which the interests of each party become the interests of the other parties' (my own emphasis).

⁷⁸Pfeffer Jeffrey and Gerald Salancik, *The External Control of Organisations: A Resource Dependence Perspective*, (1978), New York: Happer and Row Publishers, at p. 40.

⁷⁹Ibid. p. 41.

interdependent or jointly determined with the outcome achieved by the other. From this category we get two types of interdependence: *competitive interdependence and symbiotic interdependence*⁸⁰.

In competitive interdependence the outcome achieved by one party can only be higher when the outcome achieved by the other is less. In a symbiotic interdependence the output of one party is the input of the other. In other words, the outcome (product) of one party is a raw material of the other.

Behaviour or input interdependence exists in situations where the activity of one actor depends on the activity of the other. Or where the input of one party depends on the input of the other in order to achieve the intended outcome. In other words, if A does not act, B's acts become useless, the outcome is not achieved. In this kind of interdependence complementarity is reflected in the type of activities or inputs parties contribute to the relationship.

From the above meaning and examples of interdependence we gather that: First, interdependence varies with the availability of resources relative to their demand (the adequacy of assets). When there is a large amount of resources relative to their demand, interdependence is reduced. Secondly, interdependence may be caused by the uncertainty of an individual actor achieving the desired outcome when he/she chooses to act alone. In other words, the bounded rationality of a single actor, or of both, may result in interdependence. Thirdly, interdependence always leads to co-ordinated activities between actors when the desired outcome is not yet achieved or takes a long time to be achieved. Fourth, both categories of interdependence can take place in the same transaction. And, fifth, interdependence can develop between corporate actors within a single corporate firm, or between one corporate firm and another. Therefore, interdependence may be both internal and external. However, as seen above the fact that interdependence brings parties into co-operation, does not eliminate the desire for self interests (i.e. opportunism). Actors will struggle to negotiate for better returns, to try to satisfy their self interest. The issue is how this is achieved without breaking up the co-operation. This brings us to the concept of negotiation.

II. The concept of Negotiation (Bargaining).

When people who are interdependent decide to co-ordinate their commercial activities, they may involve themselves in the formation of contractual relations. There has been little analysis of the classical formal rules of contract to assess their efficiency and fairness or other socially desirable objectives to the parties. The law of contract is mainly premised on the classical concepts of

⁸⁰Ibid. pp. 41 - 45.

freedom of contract and free enterprise. Whether the contract is efficient or fair to both parties, is left to the parties themselves to determine. Courts can only interfere in limited circumstances⁸¹. However, courts have started to find it difficult to apply the classical concepts of contract. As Lord Wilberforce observes:

'It is only the precise analysis of this complex of relations into the classical offer and acceptance with identifiable consideration that seems to present difficulty....English law, having committed itself to a rather technical and schematic doctrine of contract, in application takes a practical approach, often at the costs of forcing facts to fit uneasily into the marked slots of offer, acceptance and consideration'⁸².

Some lawyers are of the view that an analysis of agreements by using offer and acceptance should be abandoned⁸³. Legal rules can not be understood properly without taking into account of the incentives for private transactions⁸⁴, because:

'.... There is wide latitude and informality in what counts as intention to accept a promise, just as the promise itself can be made in many ways'⁸⁵.

Individual parties cannot be thought to be bargaining freely. Before they enter into bargain they have different property rights and capacities. Thus, before applying the transaction costs analysis (as advocated by the aggregate of contracts theorists) the judge must decide just how altruistic the background regime ought to be⁸⁶. There is therefore an altruist and an individualist mode of argument. Although we cannot demonstrate them experimentally, these arguments are responsive to real issues in the real world. One must keep constantly in mind that the individualist arguments are drawn from the same basic source as the altruist ones⁸⁷.

Judges have to add an altruist 'substance' to an individualist 'form' and vice versa, in order to make their judgements, especially when bargains are so shocking to our norms of decency or equality, that they can not be enforceable⁸⁸.

⁸¹Circumstances like fraud and misrepresentation, coercion, mistake and now unconscionability, see Atiyah P. S, 'Contracts Promises and the Law of Obligations' 94 *L.Q. R* (1978), 193; Atiyah P.S. *The Rise and Fall of Freedom of Contract*, (1988), Oxford: Clarendon Press; Downes Antony, *A Textbook on Contract*, (1991) (2nd edn), London. Blackstone Press Ltd.; Atiyah P. S, *Essays on Contract*, (1986) Oxford: Clarendon Press.

⁸²In *New Zealand Shipping Co. Ltd. V AM Satterthwaite and Co. Ltd.*, [1975] A.C 154; [1974] 1 ALL ER 1015, 1020, compare with the dicta by Lord Denning in *Lloyds V Bundy*, [1975] Q.B 326.

⁸³Gilmore G. *The Death of Contract*, (1974), Ohio: Ohio University Press; Atiyah, *The Rise and Fall of Contract*, supra n. 81.

⁸⁴Avery Katz, 'The Strategic Structure of Offer and Acceptance: Game Theory and the Law of Contract Formation', 89 *Mich. L. Rev.*, (1990) 216, 218.

⁸⁵Fried C., *Contract as a Promise: A Theory of Contractual Obligations*, (1981), Cambridge, Harvard University Press. pp. 45 - 46.

⁸⁶Kennedy Duncan, 'Form and Substance in Private Law Adjudication', 89 *Harv. L. Rev.*, (1976), 1685, 1763; Dalton C. 'An Essay in the Deconstruction of Contract Doctrine' 94 *Yale L. J.* (1985) 1010, 1114.

⁸⁷Kennedy *ibid.* at p. 1723.

⁸⁸*Ibid.* pp. 1763 -1764.

'The effect of the contract legal rules can not be understood properly without taking into account the incentives for private transactions'⁸⁹. The outcomes of contracting do not arise in a vacuum. If one analyses how parties make their choices, the temporal sequences in which these choices occur, the costs and benefits to each party for possible sequences of action and the information available to each at each step, one can know how perfectly rational or imperfectly rational individuals make their contracts⁹⁰. The fact that there are always transaction costs of making contracts in a market and people use negotiations to reduce these costs should be taken seriously⁹¹. The costs of making negotiations possible and costs of parties strategic behaviour during the negotiation should be regarded as a part and parcel of transaction costs.

Negotiation has been defined in many ways by different analysts. To the sociologists it may mean a kind of bargaining between persons the possible means of 'getting things accomplished'⁹². Economists define it as one of the basic process of decision making in business⁹³. And lawyers see negotiation as a process of rule making and dispute settlement⁹⁴. Generally, all disciplines agree that negotiation is a process of decision making, these decisions may be rules or certain norms of procedure. Negotiation involves several parties with different values, interests or demands. The outcome depends on how the parties have agreed on the values which were being negotiated. An agreement is a *prima facie* evidence of a good outcome, assuming that no party would agree to a value that it viewed as being worse than the value of not agreeing. However, any negotiation has an outcome, since one or all parties may 'agree' not to agree.

Most writers on negotiation have addressed themselves to the question of *power* in bargaining. Because, although it is in the interests of both parties to reach an agreement on an acceptable

⁸⁹Katz supra n. 84, at p. 218.

⁹⁰Ibid. pp. 218 - 219.

⁹¹According to Calabresi: 'You have heard it said that if there are no transaction costs, any starting point will be, or will immediately and with unanimous consent lead to, an efficient end point. (That is the old law). But....I say to you that if efficiency is defined in terms of a strict Pareto test, any starting point will be, or will immediately lead to, an efficient end point, even with transaction costs. (That is the new law). Calabresi supra n. 72, at p. 1215.

⁹²Strauss A. supra n. 69; Hinde et al supra n. 73; Colman, A. supra n. 73; Alexnord, R. The Evolution of Co-operation, (1984), New York: Basic Books Inc. Publishers; Rodger Fischer and Ury William, Getting to Yes, (1981), London: Hutchinson; James Colman, 'Loss of Power' 38 Am. Soc. Rev., (1973) , pp. 1 - 17.

⁹³Zartman William, (Ed.), The 50% Solution, (1976), New Haven, Yale University Press; John Cross, The Economics of Bargaining, (1969), New York, Basic Books Inc. Publishers; Raiffa Howard, The Art and Science of Negotiation, (1982), London: Havard University Press.

⁹⁴Eisenberg A. Melvin, 'Private Ordering Through Negotiations: Dispute Settlement and Rule Making, 89 Harv. L. Rev., (1989), 634; Katz supra n. 84; White, 'The Lawyer as a Negotiator: An Adventure in Understanding and Teaching the Art of Negotiation' 19 J. Leg. Ed. (1967), 337; Wheeler Michael, 'The Theory and Practise of Negotiation: Review of H. Raiffa's Art and Science of Negotiation and Gerald R. Williams' Legal Negotiation and Settlement' 34 J. Leg. Ed. (1984), 115; Coleman and Moser 'A Bargaining Theory Approach to Default and Disclosure Rules in Contract Law', 12 Harv. J. L. Pub. Poly., (1982), 639.

allocation of values, it is equally in the interests of each party to end up with as large a piece of pie as it can or to give up as little and gain as much as possible. Power has been defined as the strategic behaviour of one party being controlled by its ability to produce such movements or re-evaluation or influence on the part of the other in order to change its behaviour in an intended direction⁹⁵. Power may be physical, economic or intellectual. How do actors use their powers to get as large a share of the pie as possible at the same time as managing to reach an agreement? Economic theorists on negotiation have tried to answer this question by using *game theories*.

Game theories are obtained from laboratory experiments where players are instructed on 'how to play' and the outcomes are observed. Generally these games are divided into two main paradigms: the co-operative (or axiomatic) approach and the non-co-operative or competitive approach. In a co-operative approach bargainers are focused as a group rather than individuals. In the sense that they are allowed to discuss and exchange information on the possible ways of making the bargaining outcomes beneficial to all the actors⁹⁶. The non-co-operative or competitive approach is grounded on individual utility maximisation. Players are not allowed to communicate, and the information they are given about others is limited. Each player struggles to get as a big piece of the pie as possible, at the same time trying not to upset the other. Otherwise, the dissatisfied party may withdraw and frustrate the whole venture. A typical example of the competitive game is the Prisoner Dilemma Game⁹⁷. However, the game played in the corporation is more of a co-operative nature than competitive because of the fact that the corporation is regarded as an arena where parties continuously discuss different ways of improving efficiency. Hence, their joint gains.

Some writers⁹⁸ argue further that the goals (interests) of each negotiator always consist of an "aspiration zone" (zone of negotiation), at one end this zone has a "resistance point" (bottom line) which indicates the limits to which he is prepared to concede. At the other end there is the "target point" which marks what he would like to achieve. The area between the resistance point and the target point is called the "settlement range' or 'agreement zone". When the settlement ranges of both negotiators overlap then a co-operative agreement is struck. The overlapping is caused by the *possibility of joint gain*, indicating elements of complementarity, profit sharing and interdependence. Therefore, the agreement zone may as well be referred to as the 'interdependence zone'. Each negotiator is ready to break the negotiation if the other pushes negotiation beyond its bottom line. However, this does not mean that the relatively stronger party

⁹⁵Zertman supra n. 93, p. 8; According to MacNeil (1979) supra n. 72 at p. 32 power means: 'the ability to impose one's will on other irrespective or by manipulating their wishes'..

⁹⁶Katz supra n. 84, p. 234.

⁹⁷Alexnold Robert supra n. 92.

⁹⁸Raiffa, supra n. 93 at p. 46; Maryon Tysoe, 'Bargaining and Negotiation' in Colman (Ed.) supra, n. 73, p. 141 at p. 156; Morley and Stephenson, The Social Psychology of Bargaining, (1977), London: George Allen & Unwin.

may not use its strength to try to change the position of the other party's bottom line⁹⁹. Raiffer proposes that in this situation a third party whom he calls an 'intervenor' is needed to help the weaker party to ensure that a bargain which serves mutual interests is struck¹⁰⁰. Katz assumes that the ultimate intervenor is the court (law) and he goes further to say that this is the reason why there are policy considerations in the process of private contracting¹⁰¹.

3:4:2. *The Corporation as a Unit of Relations.*

The relational approach has been used to develop a theory of long-term contracting in business organisations¹⁰², including the company contract¹⁰³. As far as corporations are concerned, the approach tries to explain the existence of co-operative elements, resulting from internal and external relationships of corporate actors¹⁰⁴.

To understand a corporation as a unit of relations, it must be shown first that the corporation is an arena of interdependent interests, and secondly that these interests are continuously negotiated within the corporate unit. Posner notes that the investor decides to join other investors because it has insufficient capital to invest on its own¹⁰⁵. This is an indication that there is interdependence between shareholders. While shareholders are the providers of capital, they depend on those who know how to put that capital into operation and yield surplus. These are the employees. There is therefore, interdependence between shareholders and employees¹⁰⁶. Shareholders and employees (labour and capital) need to be organised in order to have an efficient and smooth operation of the enterprise. This work is done by managers¹⁰⁷. Interdependence between corporate actors may take some or all types of interdependence. Actors are in competitive interdependence when each actor struggles to maximise its outcome (profit or gains). That is, dividends to shareholders and salary to others. Symbiotic interdependence takes place in the process of production from the first stage to the last stage¹⁰⁸. Input interdependence is present, in the sense that what each actor

⁹⁹Although in a real interdependence between the parties this may not be possible because threats of breaking the negotiation because of deadlock are high when the other party resists the change of its position.

¹⁰⁰Supra n. 93, at p. 108.

¹⁰¹Supra n. 84, at p. 295.

¹⁰²See for example MacNeil Ian, (1974); (1982); (1985); (1990), supra n. 72.

¹⁰³Drury, R.R., supra n. 72; Blumberg Phillip, The Multinational Challenge to Corporation Law, (1993), New York: Oxford University Press, at pp. 244 - 247.

¹⁰⁴According to Blumberg ibid. at p. 244: '...a juristic conception of rights, duties and liabilities arising... simply and solely as incidents of a relation aptly describe the jurisprudential nature of the law of corporate groups'. (Quoted from R. Pound, The Spirit of the Common Law, (1921) pp. 12 - 13).

¹⁰⁵Posner R, supra n 13. pp. 368 - 369.

¹⁰⁶Aoki Masahiko, 'The Participatory Generation of Information Rent and the Theory of the Firm' in Aoki, Gustafson and Willimason (Eds.), supra n. 71, at p. 26.

¹⁰⁷Aoki Ibid. at p. 26ff; Henry Hansman, 'Viability of Worker Ownership: An Economic Perspective on the Political Structure of the Firm', in Aoki et al ibid. at p. 162ff.

¹⁰⁸According to Williamson Oliver, Markets and Hierarchies: An Analysis and Antitrust Implications, (1975),

contributes at the beginning of production, determines the quality and quantity of the outcome.

In companies such as joint venture companies whose actors are highly interdependent and therefore they all actively participate in the operation and control of the company, internal negotiations replace hierarchical command, almost completely. This inevitably increases the possibility of deadlocks because of parties efforts to maintain their bottom lines. Hence, a need for an intervenor or third party.

However, as opposed to typical contract negotiations, which end when the bargain is struck, negotiations in the corporation is continuous and remains open to new negotiators to come in and old negotiators to exit¹⁰⁹. The corporation therefore is a venue of relational or long-term contracting process:

'Consequently its distribution cannot be written into individual contracts. In other words, the [company] cannot be dissolved into the bundle of individual... contracts. Rather it should be regarded as a co-operative venture in which the provision of capital by the owners (stockholders), of an organisation framework by the management, generates rents in co-operation, the distribution of which is susceptible to intra firm bargaining among these agents'¹¹⁰.

Therefore, because of the difference between normal contracts and the so-called corporate contracts, the notion of the corporation as an entity survives. Bratton observes:

'The entity idea exists and matters because of heightened *interdependence* among the parties participating in corporate ventures and institutions. Their positions demand *ongoing co-operation*, and the entity reification embodies and strengthens common goals, such as the preservation of the relationship, that enhance co-operation'¹¹¹.

But the justification for the existence of a corporation as an entity in the relational approach is different from that used by the entity theorists. Theories of the classical company law jurisprudence can only give a partial or a distorted account of the nature of a corporate entity. This is because despite their mutual hostility, they are all built on the assumption that a corporation is *something*, whether artificial, fictitious or real. In contrast, when one uses the

London: Macmillan Press, at p. 87: 'If there is high degree of interdependence among successive stages of production and if occasions for adoption are unpredictable yet common, co-ordinated responses may be difficult to secure if separate stages are operated independently'.

¹⁰⁹Williamson Oliver, 'The Firm as a Nexus of Treaties: An Introduction', in Aoki, Gustafson and Williamson, *supra* n. 71, at p. 3 he remarks: 'The fact is that the term contract can deter rather than promote an understanding of complex economic organisations'; See also Tirole Jean, The Theory of Industrial Organisations, (1988), MA: MIT Press.; However, as far as joint venture companies are concerned the allowing of new members to come in and old members to exit is subject to the maintenance of interdependence, that is, making sure that parties continue to have mutual interests and common control of the venture. Indeed, this is part of the negotiation itself.

¹¹⁰Aoki *supra*, n. 106, at p. 28.

¹¹¹Bratton *supra* n. 70, p. 427, (my own emphasis).

relational approach that 'somethingness' only comes in because of making an analogy between, on one hand, a group of business relationships involving several individuals and, on the other, an individual living person¹¹². The analogy results in changing or shifting meaning between the two categories of analogy. Through the process of making the analogy one discovers some differences which are the essence of the perception of the group of business relationships as a corporation. This leads to the application of extended or different legal rules, rather than the general rules of contract which may apply to an individual living person(s). For example, a corporation is accorded the right to exist perpetually because of the realisation that the complex business relationships which lead to the establishment of the corporation may take longer than the life time of individuals who initially formed it to materialise¹¹³. However, 'analogy' does not mean 'identity' neither does 'shift in meaning' amount to 'fiction'¹¹⁴. The company (entity) is only a legal conclusion drawn from the existence of special circumstances in business relationships between individuals which warrant the extension or change of rules which apply to such individuals to apply to the group (business relationship), legitimising the differences between individuals and a group to be regarded, controlled and protected in a manner which is more or less complex than individuals themselves. Therefore, rather than using a potentially confusing metaphor of an entity, the corporation may safely be referred to as a legal unit, legal vehicle or legal structure of business relationships¹¹⁵.

It is in the same context that a joint venture company or a group of companies may be regarded as

¹¹²According to Dias, R. W., Jurisprudence, (1985) (5th edn.), London: Butterworths, at pp. 250-251, the term 'person' as a unit of jural relations was primarily applied to individual human beings alone. But now it has been extended to groups of individuals. This warrants a technical shift in the meaning of "person" which is discovered through analogy. Thus the concept 'person' focuses large numbers of jural relations, but it allocates them different rights and obligations in different cases.; See also Hart H.L.A, 'Definition and Theory in Jurisprudence', 70 LQR. (1954), 37, at p. 40.

¹¹³Gower, L.C.B, Principles of Modern Company Law, (1992), (5th edn.), London: Sweet & Maxwell, at p. 92 says: 'One of the advantages of an artificial person is that it is not susceptible to the thousand natural shocks that flesh is heir to. It cannot be incapacitated by illness, mental or physical, and it has not (or need not have) an allotted span of life'; But this does not mean that a company though 'living' may not be considered 'dead' by law. See for example, Daimler Co. V Continental Tyre and Rubber Co. [1916] 2 A.C 307, H.L.

¹¹⁴Hart supra n. 112, at p. 59. In this sense, analogy may be made between companies and partnerships in determining the law which regulates corporate relations, but this should not be taken to mean that companies are, for that reason, partnerships, see Lord Wilberforce in Ebrahimi V Westbourne Galleries Ltd. and other [1973] A.C 360, pp. 379 - 380, where he said: "It is these, and analogous, factors which may bring into play the just and equitable clause, and they do so directly, through the force of the words themselves. To refer, as so many of the cases do, to "quasi-partnerships" or "in substance partnerships" may be convenient but may also be confusing. It may be convenient because it is the law of partnership which has developed conception of probity, good faith and mutual confidence....But the expressions may be confusing if they obscure, or deny, the fact that the parties (possibly former partners) are new co-members in a company, who have accepted, in law, new obligations. A company however small, however domestic, is a company not a partnership or even a quasi-partnership and it is through the just and equitable clause that obligations, common to partnership relations, may come in". More discussion on the issue of just and equitable clause is provided in the next chapter infra pp. 119 - 122.

¹¹⁵Blumberg supra n. 103, at pp.205-230.

a legal unit or vehicle of corporate business relationships. However, in this latter case differences between groups and individuals are more complex because the analogy is on a second or a higher level. When analogy is made on the first or lower level between an individual and a group of individuals it results in regarding the group as a single company. Yet when analogy is made on the second or higher level between a group of companies and a single company, the group may be regarded as a joint venture company or may remain as a group of companies. However, before we discuss the joint venture company further, it is important to discuss concepts which arise when one looks at the corporation from a relational approach. These are: the concepts of an *enterprise* and *groups of companies*.

3:4:3 The Company as an Enterprise.

The notion of an enterprise is one of the corner stones of the concept of a company as a unit of different relations, at any level of analogy, whether first, second or third. Studies on enterprise (law) take both a general and a more particular approach. Generally, an enterprise means 'any natural or legal person which carries on economic activities independently..., irrespective of the legal form in which the activities are pursued on, and whether they are carried on through the medium of any (sic) permanent body of any kind'¹¹⁶. The impression obtained from this definition is that any *economically independent* business activity may be an enterprise. It need not be a company or a partnership or a group of companies. Thus, one company may form several enterprises, if it has several economically independent branches. Conversely, several companies may be regarded as a single enterprise, if when considered together, they form one independent economic entity. A question may be asked as to when a single company may be regarded as an enterprise. This brings us to the particular meaning of "enterprise".

Paillusseau¹¹⁷ is of the view that an enterprise involves two interdependent and essential factors, namely: a business and a centre or focus of interests. As regards the former, an enterprise is seen as a business involving the production, transformation, or distribution of goods, or the supply of services, etc. As regards the latter, the enterprise is seen as a business organisation which involves the activities of several interests which include: the founder (entrepreneur), shareholders, creditors, employees, directors, consumers, etc. Thus, in its particular sense an enterprise is: 'the company as a going concern and the focal point of reference for continuing, long-term interests of (at least) shareholders and employees'¹¹⁸.

¹¹⁶Wooldridge Frank, *Groups of Companies*, London: Institute of Advanced Legal Studies, at p. 46.

¹¹⁷Paillusseau Jean, 'The Nature of the Company', in Drury T. Robert and Xuereb G. Peter (Eds.), *European Company Laws: A Comparative Approach*, (1991) Aldershot: Dartmouth, p. 19 at p. 24.

¹¹⁸According to Xuereb G. Peter, 'The Juridification of Industrial Relations Through Company Law Reform', *51 MLR*, (1988), 156, pp. 156 - 157; Xuereb G. Peter, 'An Enterprise Theory of a Company and Judicial

One may argue that the relational approach does not cover the business element of an enterprise, since it only discusses the relationship of different interests within the corporation, not the business. However, as observed above, business and parties' interests are interdependent factors to the extent that one cannot discuss one without discussing the other. They are only analysed separately for the purpose of a better understanding of the notion of an enterprise. Indeed, we shall argue in the next chapter that if company law is to assist companies to operate as enterprises, it must ascertain that a business exists and that the interests of those who provide and organise that business are protected. Professor Paillusseau¹¹⁹ says that the important things needed for a business include: intellectual resources; skills and work; material and non-material resources; finance; contracts, such as supply and franchise contracts; markets etc. A closer analysis of these things shows that business is a result of contributions from external as well as internal interests of the company. Further, that it is when these contributions are organised efficiently and the interests of their contributors are co-ordinated smoothly, that the company becomes an independent economic entity (an enterprise).

One of the effects of the company's struggles to maintain its economic independence is the establishment and internalisation of more relationships. This leads to the expansion of the company to include new complex interests and businesses. The process may result in the creation of the second level of business relationship, namely, a group of companies or a joint venture company which when considered together form a single economically independent entity or an enterprise.

3:4:4 *The Concept of Groups of Companies.*

A group of companies has been defined as *an economic entity*, comprising two or more companies which are connected either by reason of the power of control which the parent or controlling company exercises over the others, or by reason of being under the unified management¹²⁰. Generally, the concept of groups of companies has been introduced after the realisation that although companies operate as independent legal entities, economic reality forces some companies to control others, thereby making them dependant. The legal recognition of a dominant - dependant relationship is important in order, first and foremost, to make sure that companies operate as enterprises, and secondly, to protect interests in a dependant company.

Control Over the Exercise of 'General Meeting Power', in Drury and Xuereb, *ibid.* p. 176, at pp. 175 - 176..

¹¹⁹Supra n. 117, at p. 25.

¹²⁰Wooldridge supra n. 116, at p. 1.

Although the Anglo-American legal system has been slow in adopting the concept of groups of companies, elsewhere, particularly in Germany, the law of groups has developed more rapidly. According to the German law of groups of companies (*Konzernrecht*)¹²¹, a company is dependent on the other (the controlling or dominant company) if the latter directly or indirectly exerts a controlling influence over it¹²². Control or dominance may come about as a result of a formal contract of control, or in the absence of the contract, any relationship from which controlling influence may be implied¹²³. A parent-subsidiary relationship between companies is considered as a direct example of control. When controlling influence is proved, the controlling company is required to obey certain legal obligations and can enjoy certain legal rights. For example, it is required by law to prepare group accounts. Further, the controlling company has to compensate the dependant company, if the latter suffers loss. When it is proved that the business between the two companies was not conducted at arms' length the controlling company may be liable for the obligations of the dependant company. Also the controlling company may be required to integrate its business with the business of the dependant company in certain circumstances¹²⁴.

The concept of groups of companies in English and Tanzanian company law is recognised only as far as the relationship between the parent and subsidiary companies is concerned¹²⁵. However, as a part of the implementation of the EEC 7th Directive on consolidated accounts, some provisions have been added in the English Companies Act with the effect that parent and subsidiary undertakings may be regarded as a single group for accounting purposes where one undertaking exercises a controlling influence over the other through unified management, contract or by other means¹²⁶. English courts have gone further by extending the traditional doctrine of 'lifting the veil of incorporation' to apply to controlling shareholders in the corporate group¹²⁷. Some English

¹²¹Which form part of the *Aktiengesetz* of 1965, see Wooldridge *supra* n. 116, at p. 1; Hopt J. Klaus 'Regal Elements and Policy Decisions in Regulating Groups of Companies' in Schmitthoff M. Clive and Wooldridge Frank (Eds.), *Groups of Companies*, (1991), London: Sweet and Maxwell, p. 81, at pp 83 - 86; Hopt Klaus (Ed.), *Groups of Companies in European Laws*, (1982), Berlin: Walter de Gruyter; Immenga Ulrich, 'The Law of Groups in the Federal Republic of Germany', in Wymeersch Eddy and Fitchew, M.G, (Eds.), *Groups of Companies in the EEC*, (1993), Berlin: Walter de Gruyter, p. 85ff.

¹²²Wooldridge *supra* n. 116, at p. 1.

¹²³*Ibid.* p. 5.

¹²⁴For example, when it is proved that both companies are under a unified management. See Wooldridge *ibid.* pp. 5 - 16 for other liabilities to the controlling company.

¹²⁵See section 736 of the *English Companies Act* (1985), which is more or less the same as section 127 of the *Tanzanian Companies Ordinance (Cap 212)*. More discussion on these provisions will be provided in the next chapter *infra*.

¹²⁶According to section 258 of the *English Companies Act* (1985). More discussion on this is also provided in the next chapter pp. 143 - 144.

¹²⁷Early in 1969 Denning MR. (as he then was) in *Littlewoods Mail Orders Store Ltd. V IRC*, [1969] 1 W.L.R. 1241, at p. 1254 was of the view that: 'The Legislature has shown a way with group accounts and the rest. And the courts should follow suit'. Later in 1970, in *Charterbridge Corporation V Lloyds Bank Ltd.* [1970] Ch. 62, the issue of groups of companies was debated. In *DHN V Tower Hamlets Co.* (1976) 1 W.L.R. 852, at 857 Lord Denning was of the view that when other companies depend on the stronger company, 'The

commentators on the concept of groups of companies have also shown the need for an organised law of groups, bearing in mind that the United Kingdom is one of the countries with many groups of companies, operating all over the world¹²⁸.

The position in America is somewhat similar to that in England. However, the extension of the doctrine of lifting the veil of incorporation to attack dominant shareholders in corporate groups has been much easier in America because, in U.S., this doctrine is regarded as the rule rather than an exception¹²⁹. Courts in America recognised, a long time ago, the fiduciary duty of a dominant shareholder to the company and other shareholders¹³⁰. Also specific and general laws on groups of companies have started to develop¹³¹. For example, the Federal Securities Code has extended the meaning of 'control' to include the exercise of a 'controlling influence' over other companies¹³².

International Corporate Groups.

The concept of groups of companies tries to deal with several issues arising from the existence of transnational Corporations which entity theories cannot answer. Based on entity theories the Anglo-American legal system does not recognise the existence of a transnational corporation. Its existence is only attributed to the companies (parent or subsidiary) which form it according to the laws of states of their incorporation¹³³. Parent and subsidiary companies are regarded as separate legal entities. Consequently, the rights of overseas subsidiaries of TNCs cannot be enforced by

[companies] should ..., be treated as one, and the parent company should be treated as that one'.

¹²⁸See for example, Prentice Dan D. 'A Survey of the Law Relating to Corporate Groups in the United Kingdom' in Wymeersch and Fitchew (Eds.), supra n. 118, p. 279ff; Page Alan, 'The State and Corporate Groups in the United Kingdom', in Schmitthoff and Wooldridge (Eds.), supra n. 121, at p. 111ff; Attempt to enact this was considered in the Cork Report, Cmnd. 8558, para 1940ff.

¹²⁹Tunc Andre, 'The Fiduciary Duties of a Dominant Shareholder', in Schmitthoff and Wooldridge (Eds.), supra n. 121, p. 1, at pp. 10 - 18; Blumberg, supra n.103 pp. 84 - 88; Cashel T.W, Groups of Companies - Some U.S Aspects', in Schmitthoff and Wooldridge (Eds.), loc. cit. pp. 20 - 45.

¹³⁰See for example, Southern Pacific Co. V Bogert, 250 U.S, 483, 39 S. Ct. 533, 63 L. Ed. 1099 (1919); Pepper V Litton, 808, U.S. 295, 60 S.Ct., 238, 84 L. Ed. 281 (1939) where it was *inter alia* held that 'A Director is a fiduciary....So is a dominant or controlling stockholder or groups of stockholders.... Their powers are powers in Trust' (Quoted by Tunc ibid. at p. 10).

¹³¹Blumberg supra n. 103, pp. 104 - 116, cites Laws like Bank Holding Company Act, Savings and Loan Holding Company Act and the Public Utility Holding Company Act, as examples of these laws.

¹³²According to Section 202(29) of the Code (a) "Control" means the power, directly or indirectly, to exercise a controlling influence over the management and policies of the company..., whether through the ownership of voting securities, through one or more intermediary persons, by contract, or otherwise'. (Quoted in Blumberg ibid. p. 114).

¹³³This is what is known as the Incorporation Theory, see Mukoyogo C. Mwemezi, Conflict of Corporation Laws: The Personal Law of Juridical Persons: A Case for Tanzania, (1983), Ph.D. Thesis, Konstanz: Hartung-Verlag, pp. 29 - 40; Vagtz F. Detlev, 'The Multinational Enterprise: A New Challenge for Transnational Law', 83 Harv. L. Rev., (1970), 739, 740; Pennington R. Roberts, Pennington's Company Law, (1990), (6th edn), London: Butterworths, pp. 37 - 38.

their home parents and vice versa. But this formulation is contrary to the reality of modern business associations which is largely based on interdependence, or rather, on dependence. Most subsidiaries of TNCs established in developing countries are directly or indirectly controlled by their parent companies, which are mostly incorporated in developed countries.

However, because of the problems of extra-territoriality¹³⁴, it may be difficult for a single nation to attempt to develop the law of groups of companies to cover cross-border business associations like TNCs. An analysis of the meaning of a TNC shows that it is essentially a cross-border group of companies. It is 'a combination of companies of different nationality connected by means of share holdings, managerial control or conduct and constituting an economic unit'¹³⁵. This means that any attempt at a legal framework for cross-border corporate groups should be undertaken at the international level, or at least at the regional level.

In attempting this difficult task the UN since 1970s, through the UNCTNC has embarked on drafting different codes of conduct for TNCs. Although it is provided in one of these codes¹³⁶ that the meaning of a TNC covers all companies that operate across national boundaries through affiliates or entities, which are linked together to constitute an enterprise as a whole, the analysis of the codes¹³⁷ reveals that they are on the whole based on entity theories, rather than on the relational approach. The legal treatment of TNCs is still national, and so affects only the fragments of the TNC (subsidiaries), not the TNC as a whole enterprise.

3:4:5 *The Joint Venture Company and The Relational Approach.*

A cross-national joint venture company which is the subject of our study is one type of a Multinational corporation¹³⁸. By this very token therefore the Multinational joint venture company must be an independent economic entity¹³⁹. This raises the question of whether a cross-national joint venture company is a group of companies.

¹³⁴Blumberg supra n. 103, pp. 168 - 201, more discussion on this issue will be provided in chapter five infra.

¹³⁵Schmitthoff M. Clive, 'Group Liability of Multinationals', in Simmonds R. Kenneth (Ed.), Legal Problems of Multinational Corporations, (1977) London: The British Institute of International and Comparative Law, p. 71; Schmitthoff M. Clive, 'Multinationals in Court' J.B.L. [1972], 103, at pp. 103 - 104, he notes that the multinational '...must form an economic unit in world trade, i.e. it must have a single brain and act throughout the world as if it were one company'.

¹³⁶The General Code of Conduct to Transnational Corporations, the 1986 draft quoted by Bondzi-Simpson, E.P Legal Relations Between Transnationals and Host States, (1990) New York: Quorum Books, at p. 2.. More discussion on this issue will be provided in chapter five infra, pp. 182 - 192.

¹³⁷Provided in chapter five infra pp. 182 - 192.

¹³⁸Schmitthoff (1977) supra n.135, at p. 71. he notes that: 'within a Multinational Group, two types of subordinate companies can be distinguished, viz., controlled companies and joint ventures'.

¹³⁹Because the Multinational Corporation cannot exist unless it is an economically independent unit, see supra p.79.

Tom Hadden¹⁴⁰ argues that not all enterprises undertaken by a group of companies can properly be treated on an integrated basis because some companies within a group such as joint venture companies are operated as *wholly independent ventures*, in which special provision is made to protect the interests of both sides and to prevent the full integration of finance or management in either parent group. This view is supported by Schmitthoff¹⁴¹ who observes that the multinational joint venture company is not under the sole direction of the head office of the multinational group. Its interests are not identical with those of either of its constituent members. This is because joint ventures are formed by interdependent parties with complementary inputs and objectives. After the formation of a joint venture company parties remain independent of each other because the joint venture helps to 'join' the interdependent parts. As a result, the joint venture company is independent of the parties, and in turn the parties remain independent of each other, since they have got rid of those parts which formerly made them depend on each other. Therefore, there is a rebuttable presumption that subsidiaries form a group of companies with their parents, whereas joint venture companies do not form a group of companies of either of the parent companies. Thus, economic independence or operating as an enterprise is the only litmus paper for the existence of a true joint venture company. But if, within the joint venture company, one of the parties is allowed to go beyond the interdependence zone to interfere in the activities of other parties which fall beyond that zone, the independence of the venture and that of the other parties is jeopardised. In this situation therefore, the joint venture company and the other parties become dependants of the stronger party. The latter relationship may be referred to as a group of companies of the stronger party. This is why Hadden argues that there should be special provisions to protect the interests of the parties to the joint venture company¹⁴². This is important in order to prevent the possibility of making the joint venture company part of the stronger party's group. Inevitably, these provisions have to be those that ensure that the joint venture company operates as an economically independent entity or as an enterprise. The introduction of the law of groups of companies may also help first and foremost, to reduce the tendency of stronger parties to interfere in the activities of other parties which are beyond the joint venture relationship. Secondly, in case of interference, it will help to redress the damage.

¹⁴⁰The Control of Corporate Groups, (1983), London: Institute of Advanced Legal Studies, at p. 14 and p. 36.

¹⁴¹(1977) *Supra* n. 135, pp. 71 - 72.

¹⁴²*Supra* n. 140, at p. 14. This is because, as we have argued elsewhere in this study, the business relationship which is based on interdependence, like that of the joint venture company, has a characteristic of active participation of all actors. Thus, the protection of mutual interests of these participants is necessary, regardless whether they are majority shareholders or minority, managers or employees. This is because if the interests of one participant are not protected its withdrawal may result in the failure of the whole venture.

3:5. CONCLUSION.

The legal theory which can accommodate the joint venture company phenomenon should explain how and why co-operative and interdependent elements exist in internal and external corporate relationships despite the parties' aim of pursuing their individual interests. While the latter are features of the modern corporation, the 19th Century theories which consider a corporation as a legal entity whose internal relationships have nothing to do with the development of the theory, fall short of accommodating the joint venture company. The contrary view is expressed by the aggregate of contracts theory. However, in an endeavour to explain the internal relationships of the corporation it denies the existence of the co-operative elements which are necessary for the existence of the corporate entity. The corporation is reduced to a bundle of contracts between different corporate actors, directed by market forces to contract the way they do. If there is one thing which unites the entity and aggregate of contracts theories it is their failure to explain the existence of co-operative elements within the corporation.¹⁴³ Co-operative elements are essential for the existence of the joint venture company as an entity.

The modern world which is characterised by interdependence and market imperfections needs a theory which depicts co-operative elements within the corporation. The co-existence of individual interests within the corporation should be regarded as a starting point and the theory should proceed to explain why these interests, despite being individual in nature, continue to co-exist in a corporate form.

At the root of the answer to this question lay the concepts of interdependence and negotiation. Interdependence is present whenever an individual cannot achieve its goals on its own. In order to achieve joint interests, individuals find themselves in continuous negotiations. As long as these interests are not fully achieved negotiations will continue. This is the essence of the difference between normal contracts where negotiations are discrete and corporations where negotiations are continuous.

Negotiating parties always have the highest target which determines what they would prefer, and the bottom line beyond which they are not prepared to concede. Interdependent (overlapping) interests of negotiating parties are always found within the zone between the target point and the bottom line. As long as overlapping interests continue to exist parties are forced to continue negotiating. Hence, they are forced to co-operate. It is this kind of co-operation which makes

¹⁴³This has resulted in considering companies which are established on the basis of co-operation with the main aim of maintaining mutual interests and confidence, as quasi-partnerships or incorporated partnerships.

parties create and perpetuate an entity¹⁴⁴.

The need to maintain co-operation is one of the reasons why joint venturers, who have a relatively long-term and more complex form of interdependence, decide to incorporate their joint venture as a legal entity. However, in order to continue as an entity, and thus maintain co-operation between the parties, the joint venture company also has to exist as an economically independent entity. That is, as an enterprise. Otherwise, if the independence of the joint venture company is jeopardised, interdependent relationships between its members can easily be replaced with dominant-dependant relationships. In this sense the joint venture company may better be regarded as a subsidiary of the dominant member, or as a part of the dominant member company's group of companies.

The next chapter will test whether national company laws are able to protect the interests of parties to the joint venture company and ensure that it continues to exist as an enterprise. However, the joint venture company under discussion is a cross-national joint venture company. It therefore involves the global interests of TNCs and policy considerations of host governments. This indicates that national company laws may not be adequate to regulate them. The role of International or Regional law to these ventures is necessary and is analysed in the fifth chapter. The following figure summarises how the joint venture company may accommodate the interests of the TNC and those of local companies.

¹⁴⁴See Bratton footnote 111 supra p.74.

Figure 3.2. The Multinational Joint Venture Company Relational Framework between the TNC and a company from Developing Countries.

	INTERESTS OF THE TNC.	INTERESTS OF COMPANIES. FROM LDCs.
<i>Interests beyond Interdependence Zone, indicating the Bottom line of the TNC and Target point of companies from LDCs.</i>	<ol style="list-style-type: none"> 1. Does not like market regulation, e.g., price and production control. 2. Does not like establishment of a government controlled company. 	<ol style="list-style-type: none"> 1. Needs consumer protection by controlling prices and the quality of production. 2. Needs to control the majority shares in the company.
<i>Overlapping Interests, indicating the Interdependence Zone. That is, the joint venture company structure.</i>	<ol style="list-style-type: none"> 1. May accept a private company. 2. Has technology. 3. Has managerial skills. 4. Has foreign capital or may guarantee a foreign loan capital. i. Needs local market. ii. Needs to be familiar with local conditions. 	<ol style="list-style-type: none"> i. May accept a private joint venture company. ii. Needs foreign capital. iii. Needs foreign Technology. iv. Needs foreign market. v. Needs Managerial Skills. <ol style="list-style-type: none"> 1. Has cheap labour 2. Has influence on local legal & political conditions. 3. Has access to local markets.
<i>Interests beyond Interdependence Zone, indicating the Bottom line of companies from LDCs and the Target point of the TNC.</i>	<ol style="list-style-type: none"> 1. Needs global standards and qualities. 2. Needs company which is only regulated or controlled by market forces. 	<ol style="list-style-type: none"> 1. Does not like TNC's global standards and prices. 2. Does not like private - unregulated companies.

CHAPTER FOUR

JOINT VENTURE COMPANIES: COMPANY LAW PERSPECTIVES.

4:1. INTRODUCTION.

The intention of this chapter is to analyse company law provisions and doctrines to see whether and how they can apply to joint venture companies. As seen from the previous chapter, the joint venture company must inevitably exist as an enterprise. The enterprise's existence depends on two interdependent factors, namely: the existence of a sound business and a well balanced legal framework of interests. The focus of this chapter will be on the provisions and doctrines in company law which aim to achieve these two factors. The chapter begins with an analysis of the provisions which deal with the interests within the company and goes on to analyse how company law makes sure that joint venture companies have a sound business and operate as enterprises.

PART I.

JOINT VENTURE COMPANY'S INTERESTS AND COMPANY LAW.

Unlike other types of companies, the joint venture company connotes a company where the relationship between participants is purely commercial, but where parties nevertheless actively contribute to the company, be it in its formation, financing, managing and operating its production, and marketing or sharing its products, etc.¹ This study will limit itself mostly to the participation of the internal interests namely, shareholders, management and employees. However, it is important to analyse first how company law treats or protects the interests of those who participate in the joint venture company's formation.

4:2. FORMATION OF A JOINT VENTURE COMPANY.

Legally speaking, not much is known about the company before its incorporation. This stems from the belief that a company is a creature of law which only starts to exist after incorporation. However, it is now generally accepted that before incorporation there are many things which have

¹See Elizabeth Jane Boros, Minority Shareholders: Prevention and Remedy of Common Grievances, (1992), Ph.D. Thesis, Cambridge University, at p. 41.

to be done. These include: the appraisal of the business proposition, the arrangement of the initial finance, the negotiation of different contracts etc.². In company law all these activities of 'forming' a company are grouped under the notion of promotion.

The legal approach to the concept of promoting a company has never fully crystallised. The position is as it was put by Bowen J. in Whaley Bridge Calico Printing Co. V Green and Smith³, that:

'The term promotion is a term not of law, but of business, usefully summed up in a single word - a number of business operations familiar to the commercial world by which a company is generally brought into existence'.

Company law is hesitant to give a precise meaning to promotion⁴. A promoter is regarded as "the illegitimate child of law"⁵. Lawyers argue that the question of what is promotion and who is a promoter in law is a question of fact to be decided in each particular case⁶. This is because, as Cohen explains:

'If you attempt to give a definition, you may easily limit, instead of doing what I think you have in view, namely, expand the scope of what is promotion, and someone might escape liability who ought to be brought into the ambit, because you cannot amend the Act everyday'⁷.

However, elsewhere Judges have attempted to give the general meaning of a promoter. For example, in the American case of Old Dominion Copper Mining etc. V Bigelow⁸, Judge Rugg was of the view that:

'In a comprehensive sense, 'promoter' includes those who undertake to form a corporation and to procure for it, the rights, instrumentalities and capital by which it is to carry the purpose set forth in its charter, and to establish it as fully able to do its business.

Their work may begin long before the organisation of the corporation, in seeking the opening for a venture and projecting a plan for its development, and may continue after the incorporation by attracting the investment of capital in its securities and providing it with the commercial breath of life....'.

The above description shows that a promoter is crucial to the life of the company. Indeed, as Judge Rudd shows, promoters are the ones who ascertain that a company has a sound business.

²Farrar, J. H. Farrar's Company Law, (1991), (3rd edn.), London: Butterworths, at p. 52.

³(1880) 5 Q.B.D, 109, at p. 111.

⁴Farrar, supra., n. 2 at p. 53; Gross Joseph, H. 'Who is a Promoter', L.Q.R., (1970), 493, at p. 498.

⁵Gross ibid. at p. 495.

⁶Gower, L. C.B., Gower's Principles of Modern Company Law, (1992), (5th edn), London, Sweet and Maxwell, at p. 297.

⁷As per Cohen J, in the Cohen Committee Report, also quoted by Gross, supra n. 4, at p. 297.

⁸Mass. 159, 177, 89 N.E, 193, 102 (1909).

Duties and Rights of a promoter.

Although the promoter is an important person in forming the company, his rights and duties are subject to no special provisions in company law statutes. Liability is imposed on promoters only for untrue statements in listing particulars in the prospectus and for non-disclosure of some facts in the contracts to which they were parties before incorporation of the company⁹. Courts, however, have established fiduciary duties of disclosure and accounting to cover all that is done in the process of forming the company¹⁰.

Promoters of the joint venture company.

The process of forming a joint venture company is, by and large, more complex than that of other companies and may involve different procedures and negotiations. For example, in developing countries, the process may start with the study and appraisal of the project to determine its viability and evaluate the assets which are to be used by the joint venture company. After the feasibility study, when the decision to start the joint venture company is reached, there follows the negotiation of different agreements such as loan agreements and shareholders agreements. The general impression is that, all those who participate in these dealings should be regarded as promoters of the joint venture company¹¹. Thus, they deserve rights and duties similar to those accorded to the promoters of other companies. However, in the joint venture case some different problems may be foreseeable.

⁹See sections 36 - 38 of the Tanzanian Companies Ordinance (Cap. 212), the English position has slightly changed as it is discussed *infra* at p. 89. As will be indicated further in chapter six, the Companies Ordinance has not changed much since its enactment in 1932. This is because few years after independence Tanzania decided to pursue planned socialist economy whereby most attention was paid to the establishment of public enterprises. The only substantial changes to the Ordinance were made in 1972 to regulate the expatriation of dividends (see The Companies Ordinance (Regulation of dividends and surplus) Act of 1972), and in 1973 to require subsidiaries of TNCs to register themselves (see The Companies (Incorporation of Branch of Foreign Companies) Order, GN. No. 20 of 1973.).

¹⁰For example, (a) a duty not to make secret profits at the expense of the company, see Erlanger V New Sombrero Phosphate Co., (1878). 3 App. Cas. 1218, 39 L. T, 269. The promoter who makes full and frank disclosure to an independent Board of Directors, or to the existing potential shareholder is regarded as to have not made secret profits, see Gluckstein V Barnes [1900], AC, 240, HL, at p. 247. (b) A duty is also imposed on a promoter to account to the company for the benefits of any subsequent contracts for the acquisition of property which he intends to sell to the company, after incorporation, see Re Leeds and Hanley Theatres of Varieties Ltd. [1902] 2 Ch. 809; Tracy v Mandalay Pty. Ltd. (1952), 88 CLR, 215, at p. 239. (c) A promoter must not exercise undue influence or fraud in the process of promotion, for example hiding his interests through a nominee. This was held in Erlanger case *loc. cit.* In case of proof of breach the company may rescind the contract, sue for recovery of secret profits, or sue for damages for a breach of fiduciary duties or deceit, see generally Sealy, Cases and Materials in Company Law, (1989), (4th edn.), London, Butterworths, at p. 25; Gluckstein V Barnes *loc cit.*

¹¹If we adopt the description of a promoter as put forward by Rugg J. *supra* p. 108.

Firstly, the fact that most joint venture companies formed in developing countries are private companies makes this issue complicated. This is because since the publication of the prospectus is mandatory only for public companies¹², a private joint venture company promoter may escape liability. Therefore, the Common Law fiduciary duties discussed above¹³, are important to the promoters of joint venture companies.

Secondly, even if fiduciary duties are applied, it may be difficult to prove whether the disclosure was made to independent directors or members of the joint venture company. This is because in most cases joint venture promoters are the prospective members and directors of the joint venture company. Therefore, rather than contemplating a situation where directors of the joint venture company will be independent of their 'employers' (i.e., parent companies), the key issue should be whether the joint venturer who participated in the promotion made a full disclosure to other joint venturers. This is because in cases where management is provided by one of the members¹⁴ it is very difficult to prove the independence of the board of directors.

Problems of ascertaining disclosure also affect the just remuneration of the joint venture company's promoters. In some instances promoters who participate in the pre-incorporation services like the feasibility study, preparation of the action plan, etc., are rewarded by converting their service into equities (founders shares). Despite the fact that some services are made in order to enable the promoter to decide whether to invest in the joint venture company or not. They are not made in the interests of the company¹⁵. According to the case of *Re Eddystone Marine Insurance*¹⁶, it is illegal to convert pre-incorporation services into equities, as this amounts to past consideration. Gower¹⁷ is of the view that some of the so-called services are merely 'window-dressing' which enable the promoter to do better than other shareholders if the company proves a success. This complicates the whole process of joint venture formation in developing countries. A founder (promoter) who acquires membership merely because of the services it rendered before incorporation will influence the ratification of the 'contract' of service even if the shares it was allotted do not reflect the true value of the services, or even if the so called services were not in the interests of the company.

¹²For example, see sections 36 - 38 of the Tanzanian Companies Ordinance supra n. 9.

¹³Supra n. 10.

¹⁴This is the case in many joint venture companies formed in developing countries. See for example, Giorgion Barbra Navetti, Joint Ventures in Developing Countries, (1991), D.Phil. Thesis, Cambridge, University. Our study on six joint venture companies from Tanzania shows that all had management which was provided by the foreign partner, i.e., the TNC, see chapter six infra, pp. 225 - 242.

¹⁵That is, the services are rendered before the idea to establish a joint venture company is thought of. The company promoter usually makes a proposal for the establishment of the joint venture company to other prospective members after discovering from the study that the project is worth taking.

¹⁶[1893] 3 Ch. 9 (CA).

¹⁷Supra n. 6 at p. 305.

In the above situation, the solution may lie in the strict application of the Common Law position. If services are rendered by the promoter before the formation of the company they should not form part of equities. The promoter should be required to pay for its shares in cash or tangible assets if it becomes a member of the joint venture company. Conversion of services into equity, if not well arranged or negotiated, may result in the allotment of 'free' shares, and the whole process of 'joint venturing' may become a sham.

Pre-incorporation contracts and dealings.

In law, until the company has been incorporated, it has no legal capacity to contract, nor is it bound by contracts which were concluded before its incorporation¹⁸. However, it is an obvious fact that in modern business arrangements such as joint ventures which are based on interdependence, the negotiation of different agreements, determining the type of company to be incorporated, is too important to be ignored by law. Some methods are needed to ensure that those who participate in the negotiations and conclusion of these agreements are protected from, or compensated for, the necessary liabilities which arise in the process of negotiation, or to ensure that they are not allowed to exploit the unclear position of the law at the expense of the company they intend to incorporate.

The Common Law position on pre-incorporation contracts is that if the promoter enters into any contract 'for and on behalf' of the company, he is personally liable¹⁹. But if the promoter signs the proposed name of the company, adding his own to authenticate it, there is no contract at all²⁰. This position means that unless the company enters into a new contract, the pre-incorporation contract cannot bind the company. In this case ratification or adoption of the old contract is not enough²¹.

The position of English Company Law has changed slightly with the implementation of Art. 7 of the EEC First Company Law Directives. This article has the effect of making persons who acted in the name of the company before its incorporation, jointly and severally liable, unless the

¹⁸Kelner V Baxter (1866) L. R. , 2 C.P 174; Natal Land Colonisation Company V Pauline Colliery & Development Syndicate [1904] A.C 120 (P.C)

¹⁹Kelner V Baxter *ibid*.

²⁰Newborn V Sensolid (G.B) Ltd. [1954] 1 Q.B 45 (C.A); Black V Smallwood [1966] A.L.R 744 (Australian High Court).

²¹Kelner V Baxter *supra* n. 18. In this sense the joint venture shareholders' agreement may be regarded as a pre-incorporation agreement. However, parties to this agreement always include a clause indicating that the agreement should not come into force until the joint venture company is legally formed in which case the joint venture company will automatically become a party to this agreement.

company assumes the liability after incorporation²². However, the amendment of the English Companies Act which introduced section 36C(1) does not so far change the common law position on the assumption of liability after incorporation²³.

The EC position may have some problems when applied to joint venture companies, especially those in developing countries. It assumes that the company which is formed is totally independent of the promoters, that members of the company are adequately informed to be able to endorse fully the pre-incorporation contracts or to reject them. In the case of joint venture companies established in developing countries, the case may be different. After the formation of the joint venture company, some promoters remain in a sufficiently strategic position to be able to influence the decision whether or not to endorse those contracts, especially when they become members or participate in the management of the joint venture company. Some pre-incorporation contracts deal with the transfer of intangible or tangible assets the value of which cannot be fully assessed, unless an independent valuer is employed. Again, some of the assets transferred involve skills which cannot be easily valued or can only be evaluated after a certain period of time has elapsed. The fact that parties from developing countries do not have technical and managerial skills and participate in joint ventures to acquire these assets should not be ignored²⁴. Therefore, what matters is not the question of endorsing the contracts but how the endorsement is reached. In this case proof that these contracts had an independent assessment before endorsement, especially as far as the valuation of their subject matter is concerned, may be necessary.

4:3. THE JOINT VENTURE CORPORATE CONSTITUTION.

4:3:1 GENERAL LEGAL ISSUES ON THE CORPORATE CONSTITUTION.

The position of the established joint venture company as an economically independent venture, (an enterprise) depends on the structure of its constitution and how its members exercise their powers and rights under the constitution to maintain that position. In this part, an analysis is made

²²Gower *supra* n. 6 at p. 307.

²³The section reads: 'A contract which purports to be made by or on behalf of a company at a time when the company has not been formed has effect, subject to any agreement to the contrary, as one made by a person purporting to act for a company or as agent for it, and he is personally liable on the contract accordingly'. The correctness of this section was doubted by Prentice that it does not implement fully the intention of the Directive in, 'Section 9 of the European Communities Act', 89 *L.Q.R.*, (1973), 518. The position by Prentice was accepted in *Phonogram Ltd. v Lane* [1982] QB 938, (C.A) and has been made clear by Green, 'Security of Transaction After Phonogram' 47 *M.L.R.* (1984), 671; See also Griffith Andrew, 'Agents Without Principals: Pre-incorporation Contracts and Section 36C of the Companies Act, 1985', 13 *Legal Studies*, (1993) 241, he recommends further reforms in the section.

²⁴See Navetti *supra* n. 14; See also our discussion in chapter two *supra* pp.15 - 17.

of company law issues which may affect the constitution of the joint venture company.

The constitution of a company consists of two statutory documents: the memorandum and articles of association²⁵. The general purpose of the constitution is to provide for the distribution of risks, profits and losses, and the control of the internal interests²⁶. Legally speaking, the constitution of a company is a statutory contract. However, the fact that the parties to this 'contract' cannot be easily identified has been a matter of controversy in the past, and it may very well be in the future, because of the unsettled nature of the company law theory. New forms of companies such as joint venture companies have once more exacerbated the situation.

According to what is now Section 14 of the English Companies Act and Section 21 of the Tanzanian Companies Ordinance, the memorandum and articles of association, after registration, bind the company and the members thereof to the same extent 'as if they respectively had been signed and sealed by each member, and contained covenants on the part of the members to observe all the provisions of the memorandum and articles'. Commentators²⁷ on this provision have easily agreed that the provision has the effect of regarding the constitution of a company as a statutory contract. The main area of contention, however, is on determining whether this contract binds the members *inter-se*, or only binds members and the company, and, whether 'outsiders' are protected by the constitution of the company. In essence, this shows that, there have been attempts to look at the constitution of the company from point of view of the general principles of contract law. Therefore, in order to have a satisfactory answer as far as these issues are concerned, and to consider how they affect the constitution of the joint venture company, the analysis recalls the theories of the company discussed in the third chapter.

As was shown in the third chapter, the aggregate of contracts approach treats the constitution of the company as a form of contract²⁸. In this sense the constitution of the company binds the members *inter-se*. The classical contractual approach could not explain how members could be differentiated from the company. It was accepted that the company as an entity existed, albeit for

²⁵Farrar supra n. 2 at p. 95; Pennington, Pennington's Company Law, (1990), (6th edn.), London: Butterworths, at p. 3; Gower supra n. 6, at p.273.

²⁶Jeffrey N. Gordon, 'The Mandatory Structure of Corporate Law', 89 Colum.L.Rev. (1989), 1549, 1555ff.

²⁷See for example, Roger Gregory, 'The Section 20 Contract' 44 M.L.R., (1981), 526; Gower L.C.B., 'The Contractual Effects of Articles of Association', 2 M.L.R., (1958), 401; Wedderburn, K.W., 'Shareholders Rights and The Rule in Foss V Harbottle' C.L.J. [1957], 194, [1958] 93; Goldberg, G.D. 'The Enforcement of Outsiders Rights under Section 20(1) of Companies Act 1948', 35 M.L.R., (1972) 367; Drury R.R. 'The Relative Nature of Shareholders Rights to Enforce the Company Contract', C.L.J. [1986], 219; Golderberg, G.D 'The Controversy on Section 20 Contract Revisited' 48 M.L.R., (1985), 158.

²⁸See mainly our discussion in chapter 3 supra pp 63 - 66., See especially Posner Richard , Economic Analysis of Law, (1986), (3rd edn.), Cambridge: Harvard University Press, ch. 14, especially at pp. 369 - 372, where he describes a corporation as 'a standard form contract'; Easterbrook H. Frank and Fischel R. Daniel, 'The Corporate Contract', 89 Colum.L.Rev. (1989), 141.

convenience, without giving any reason for that existence²⁹. This was a major weakness which was fully exploited by the legal entity approach. The new aggregate of contracts approach does not recognise the existence of the entity. Therefore, the issue whether the company's constitution also binds the company *vis-à-vis* its members does not arise³⁰.

The legal entity approach which starts from the premise that a company exists independently of its members³¹, considers sections 14 of the English Companies Act and 21 of the Tanzanian Companies Ordinance to have the effect of creating a contract between the company and its members. To this extent, the sections do not create the contract between members *inter-se*³². In other words, the sections mean what they say. Attention is paid only to the issue of whether the company contract is limited to a member *qua* a member or can be extended to apply to a member in other capacities. That is, to protect what are called outsiders' rights³³. As regards this subsequent issue there are again two views. The first view interprets the provisions strictly to the effect that the contract applies to the members *qua* members only³⁴. The other contends that a member, by virtue of being a party to the statutory contract, has a right to compel the company to enforce the right which he/she enjoys not *qua* a member, provided these rights are included in the memorandum and articles of association³⁵.

Although the legal entity approach recognises the existence of the company as a party to the statutory contract, it has failed to explain how and why the company becomes a party to the contract. Moreover, this approach does not recognise the fact that the statutory contract can be enforced between members *inter-se*.

The relational approach recognises the fact that the constitution of the company is essentially contractual. Thus, supporting the interpretation of sections 14 and 21. But it goes further to recognise the fact that the constitution of the company creates a long-term relationship between

²⁹See our discussion in chapter 3 supra, pp. 63 - 66.

³⁰Chapter three supra. pp. 63 - 66.

³¹Chapter three supra . pp. 54 - 60..

³²Gower supra n. 27; Gregory Rodger supra, n. 27; See also London Sack & Bag Co. Ltd. V Dixon & Lugton, [1943] 2 ALL ER, 763, C.A.

³³Wedderburn; Gower; Goldberg, supra n. 27; See also the holding in Hickman V Kent or Romney Marsh Sheepbreeder's Assoc. [1915] 1 Ch. 881 and Houldsworth V City of Glasgow Bank (1880) 5 App. Cas. 317.

³⁴This view is maintained by Gower ibid. at p. 401.

³⁵For example Wedderburn, K.W, [1957] C.L.J., supra n. 27; Supported later by Prentice G.N. 'The Enforcement of Outsiders Rights' 1 Company Lawyer, (1980), 179; Marshal D. Evans, 'Quantum Meruit and The Managing Director', 29 M.L.R., (1966), 608; Goldberg supra n. 27. This interpretation is used to offer shares to the members of the management and employees whose contributions to the company are crucial for its existence. Therefore, members of the joint venture company who join to provide managerial skills and technical know-how have to have some shares in the company to enable them protect their interests as managers or employees.

the members. Because of interdependent interests and the continuation of the business, parties are bound up in the same enterprise³⁶. Therefore, although the memorandum and articles give rights to individual members, they should not be looked at in isolation, but only in relation to the rights enjoyed by other members. In fact, this is what the sections mean. They mean that the articles and the memorandum, bind each member and may, through that process, bind the company. This means that there are rights which a member can enforce against other individual members and there are rights which a member can enforce against the company (overlapping interests of members). The company exists only in those interests that overlap³⁷. As far as these interests are concerned the rights of one member depend on the rights of other members and vice-versa. These rights cannot be enforced without affecting those of others. But as far as the rights which do not overlap are concerned, they are exclusive rights of individual members. Since these are individual rights *per-se*, they can be enforced between members *inter-se* through separate agreements. When these rights are included in the constitution they remain individual rights and thus they form an exception to the general rule³⁸. This explains why in a company's constitution there should be internal procedural rights as well as personal proprietary rights³⁹.

When looked at from the relational approach therefore, the constitution of the company has two faces. One face indicates the relationship between members and the company in cases where overlapping interests of members are at issue. The other face indicates relationships between members *inter-se*, in cases where the exclusive interests of individual members are concerned.

The Constitution of the Joint Venture Company.

From the above general discussion and the nature of joint ventures it follows that the constitution of a joint venture company should be considered from a point of view which recognises that long-term business relations require permanent business structures. If the general purpose of the constitution of a company is to provide for the distribution of risk, profit and control between members, the constitution of the joint venture company should include only those provisions which deal with risk and profit sharing, and joint control between members⁴⁰. However, this may not be enough since the constitution has to be altered from time to time⁴¹.

³⁶The analysis of a company constitution from a relational approach was made by Drury R.R, supra n. 27, at p. 222 he says: 'The concept of a long-term contractual relationship exactly fits the contract that underlies the workings of companies. The parties are bound up in the same enterprise, and have to "do business" with each other over a long period of time'. But in contra, see the views of Wedderburn in his later article, 'Control of Corporate Action', 52 M.L.R. (1989) 401.

³⁷See our discussion in chapter 3 supra pp. 66 - 81.

³⁸The rule in *Foss V Harbottle*, discussed infra pp. 108 - 111.

³⁹Drury supra n. 27 at pp. 238 - 244.

⁴⁰See our discussion in chapter 3 supra pp. 66 - 81.

⁴¹See our discussion infra pp 97 - 100..

The company law of both England and Tanzania⁴² leave parties to determine what they should include in the constitution of their company unless they simply adopt the model constitutions provided in the Company Act schedules. But the process of forming a joint venture company involves other issues which need to be addressed. For example, in the joint venture company the selection of the partner is very important if the venture is to succeed. Interdependence in the joint venture company requires that only parties with mutual interests, confidence and trust should be members⁴³. Again, in the joint venture company contribution is rarely made in cash. In most cases it is made through tangible and intangible assets⁴⁴. These need to be valued in order to meet the requirement of capital and allotment of shares which are deemed paid up. Provisions to this effect have to be included in the constitution of the joint venture company⁴⁵. In other words, while in other companies members may not be certain of the magnitude and the cost of the project and need not express it in specific terms, in the joint venture company the magnitude and costs of the project, determined by the contribution of each party, has to be known *ex-ante*. It is in the nature of the project and the contributions of the parties that the contribution of each party can be ascertained. For example, which party may contribute managerial skills, or the necessary technology or certain assets etc. It does not make sense to provide in the constitution that the management of the joint venture company shall be provided by a board of directors to be appointed in the general meeting, when it is known that it is already agreed that one member will provide managerial skills to the venture which are to be valued and given in return for shares deemed paid up by that member. The same applies in determining the distribution of profit and the control of the joint venture company. For example, issues such as distribution of dividends and salary to the manager *cum* shareholder have to be addressed. Decisions must also be made on how to quantify profits and how to remunerate members who join the joint venture with the main objective of gaining managerial skills and know-how. As a result issues such as who decides when and how profits are distributed have to be addressed and included in the constitution. The inclusion of these peculiar features of the organs of the joint venture company in its constitution present a big challenge to those who draft it. It also emphasises the point that the constitution of the joint venture company should be specifically and carefully drafted to reflect the notions of active participation of all members, risk and profit sharing and joint control. Because of the circumstances which are peculiar to joint ventures, parties may find that the 'standard' memorandum and articles of association do not fulfil the purpose for which the joint venture is to

⁴²Section 14 of the English Companies Act (1985), as amended in 1989, (hereinafter referred to as the English Companies Act), and section 21 of the Tanzanian Companies Ordinance, (Cap 212), (hereinafter referred to as the Tanzanian Companies Ordinance)

⁴³Beamish Paul, Multinational Joint Venture in Developing Countries, (1989), New York: Routledge, at pp. 7 - 10. See our discussion in chapter two supra pp.28 - 31.

⁴⁴See our discussion infra pp. 146 - 154.

⁴⁵Because of the normal share capital requirements as discussed infra pp.146 - 154, see also Appendix 1.

be established and they may decide to supplement these documents with other agreements.

Supplementary agreements and the joint venture companies' constitution⁴⁶

In a company where members feel that statutory provisions are inadequate to regulate their relationships, it is common to supplement the required statutory documents with other separate agreements. These agreements derive their power/legality from the statutory documents⁴⁷. They are common in joint venture companies formed in developing countries. They include: the joint venture shareholders agreement, management agreement and technical services agreement⁴⁸.

Shareholders Agreements.

According to Farrar⁴⁹ shareholders agreements are usually of three kinds:

- '(a)An agreement between the company and the members, collateral and supplementary to the articles;
- (b)An agreement between all shareholders *inter-se*;
- (c)An agreement between some of the members [i.e., a class of members]'

The legal position as regards the agreement between members and the company was made clear in the case of *Shalfoon V Chaddar Valley Co-operative Dairy Co. Ltd*⁵⁰. In the case Salmond J tried to show the difference between the obligations the shareholder that he has in the articles and those which he has in the separate agreement *vis-à-vis* the company. In particular, he said that the obligations in the articles bind current as well as future shareholders but 'contractual' obligations are purely personal and bind only individual shareholders who are parties to the contract, and they cannot, therefore, run with the shares as appurtenant thereto in the hands of other shareholders⁵¹.

⁴⁶For a general discussion of these agreements see Farrar supra n. 2 Ch. 9; Stedman Graham and Jones, *Shareholders Agreements*, (1990), London: Longman; Sealy, L. S, 'Enforcement of Partnership Agreements, Articles of Association and Shareholders Agreements' in Finn P.D (Ed.) *Equity and Commercial Relationships*, (1987), Sydney: Law Books Company Ltd. pp. 89 - 113; Finn Paul, 'Shareholders Agreements', *6 A.B.L.R.*, (1978) 97.

⁴⁷One may argue that in the joint venture company the contrary may also be true. This is because usually it is the Joint Venture Shareholders Agreement which provides that the parties shall be formed as a company and thereafter the company shall enter into other supplementary agreements. See our discussion in chapter six infra, pp.234 - 238, provided also in appendix 1.

⁴⁸See Navetti supra n. 14; See also our discussion in chapter six infra pp. 234 - 242; See also Edger Herzfeld, 'Co-operation Agreements in Corporate Joint Ventures', *J.B.L* [1983] 121 - 129; Cooke Gerald and Yates David, 'Legal Problems in Financing Maritime Joint Ventures', *J.B.L* [1989] 197; Edger Herzfeld, *Joint Ventures*, (19183) Bristol: Jordan and Sons Ltd. pp. 41 - 63.

⁴⁹Supra n. 2 at p. 139.

⁵⁰[1924] N.Z.L.R 561 at p. 562, referred also by Farrar *ibid.*; However, see cases and articles cited in fn 53 infra.

⁵¹According to Elizabeth supra n. 1 at p. 43 the advantage of articles over shareholders agreements is that the

The second difference is that the regulation in the articles is altered or repealed by the company, whereas the contract is altered by mutual consent of the parties. Thirdly, the regulation should be within the ambit of company laws for it to be valid, whereas the contract is only subject to the general laws of contract. Thus, the shareholders agreement remains personal and cannot bind the members of the company in their capacities as members. In this sense, if the members enter into an agreement which has the effect of altering the constitution of the joint venture company, the alteration has to go through the legal process as provided by company law. Otherwise, it is open to challenge by a party or a member who does not accept it⁵². In other words, while shareholders may enter into a contract with the company in the normal course of business, those contracts should not affect the constitution of the company unless they go through the legal process of altering the constitution of the company. This means that the joint venture shareholders agreement in itself does not form part of the joint venture company's constitution, unless the constitution of the joint venture company is altered to that effect. Conversely, the company's constitution cannot affect contractual rights and obligations under the joint venture shareholders agreement to vote according to their agreement to alter the constitution of the company, unless that alteration is restricted by law⁵³.

A shareholders' agreement can deal with all matters which concern shareholders' interests in that capacity without altering the constitution⁵⁴, provided it does not affect the legal rights of other shareholders or members of the company as laid down in the constitution of the company or company law. This restriction will apply for example, where the agreement purports to limit the powers of the shareholder which he exercises as a director⁵⁵ or where the agreement purports to fetter the company's capacity to alter its articles⁵⁶. Also, shareholders agreements are not permitted to affect the constitution of the company by inducing other shareholders to vote or act

company's legislation gives contractual effect to the articles so that its provisions automatically bind subsequent members without the need for actual extension of articles; See also Colin Baxter, 'The Role of the Judge in Interpreting Shareholders Rights', C.L.J. [1983] 96.

⁵²Farrar *ibid.* at p. 140.

⁵³ This was the view in Cane V Jones [1980] 1 W.L.R, 1451; See also Sealy L.S 'Breakdown of Brotherly Love in a Boardroom', [1981], C.L.J. 224; See also Baxter *supra* n. 51; See also the arguments in Russell V Northern Bank Development Corporation Ltd. [1992] 1 W.L.R, 588; Welton V Saffery [1987] AC 299, especially the argument by Lord Davey at p. 331; Generally see Ferran Ellis, 'The Decision of the House of Lords in Ruseell V Northern Bank Development Corporation,' C.L.J. [1994] 343; Davenport, B. J 'What Did Russell V Northern Bank Development Ltd. Decide?', 109 L.Q.R. (1993), 553; Riley, C.A 'Vetoes and Votes Agreements: Some Problems of Consent and Knowledge' 44 N.I.L.Q. (1993) 34.

⁵⁴Farrar *supra* n. 2 at p. 140.

⁵⁵*Ibid.* at 140; See also cases cited *infra* n. 56.

⁵⁶See for example Greenhalgh V Mallard [1943] 2 ALL ER 234, C.A; Also see cases cited *supra* fn. 53; See also British Murac Syndicate Ltd. V Alpertown Rubber Co. Ltd. [1915] 2 Ch. 186; Southern Foundries (1926) V Shirlaw [1940] AC 701; Allen V Gold Reefs of West Africa Ltd. [1900] 1 Ch. 656; Punt V Symons & Co. Ltd. [1903] 2 Ch. 506; See also Russell V Northern Bank Development Corporation, *supra* n.53.

in a particular way by fraud, bribery or threats⁵⁷.

From the above discussion, it is clear that shareholders agreements which contain a clause giving the provisions of the agreement priority over conflicting provisions of the constitution of the joint venture company⁵⁸ cannot be enforced against the company or against other members of the company who are not parties to the agreement. The agreement prevails as far as those who entered into it are concerned, so long as it does not affect the interests of other members. This once again emphasises the importance of having a concise and specific constitution for the joint venture company, especially in countries where the alteration of the memorandum of association is restricted⁵⁹.

Management Agreements.

Joint venture companies may delegate the whole or part of their management to one of the members or to an outsider through an express agreement, called a management contract⁶⁰. The legal position as regards management agreements is that the power to delegate should be derived from the constitution of the company⁶¹. Therefore, in order for the management agreement to be recognised by law its formation should be permitted by the constitution, not by the joint venture shareholders' agreement⁶². This is also important, because, unless the management agreement is negotiated by all members, there is a rebuttable presumption that it alters the constitution of the joint venture company as initially negotiated⁶³.

4:3:2. THE ALTERATION OF THE JOINT VENTURE COMPANY'S CONSTITUTION.

The alteration of the company's constitution as provided by law differs between the memorandum and articles of association.

⁵⁷Elliot V Richardson (1870) L.R, 744; The draft of the EEC 5th Directive, article 35 avoids agreements in which a shareholder undertakes to vote in one of the following: (a) always to follow the instructions of the company or one of its organs, (b) always to approve the proposals of the company or one of its organs, and (c) to vote in a specified manner or abstain in consideration of special advantages.

⁵⁸See for example, the Joint Venture Shareholders Agreements discussed in chapter six *infra* pp. 234 - 238.

⁵⁹For example, the law of Tanzania still restricts the alteration of the memorandum of association, see our discussion below.

⁶⁰Investment Trust Corporation Ltd. V Singapore Traction Co. Ltd. [1935] Ch. 615. Examples of these agreements are discussed in chapter six *infra* pp 238 - 240.

⁶¹Farrar *supra* n. 2 at pp. 95 - 98.

⁶²It will be seen in the sixth chapter that management and technical services agreements are usually regarded as parts of the shareholders agreement.

⁶³This is because to the joint venture company in developing countries management skills forms an important part of contributions by one of the members.

The English position as far as the alteration of the memorandum of association is concerned, has changed significantly. Although section 2(7) of the Companies Act, expressly forbids the alteration of the memorandum of association of the company 'except in cases, in the mode and to the extent for which express provisions is made by [the] Act'⁶⁴, the company may alter its memorandum of association in several circumstances⁶⁵.

In Tanzania, the position follows the 1948 English Companies Act where the memorandum is altered in only seven circumstances which are provided by section 7 of the Companies Ordinance⁶⁶.

Therefore, it would seem that while the English position as far as the alteration of the constitution of the company is concerned, is more flexible, Tanzanian company law still restricts the company's ability to alter its memorandum of association. This study argues that allowing alteration of the memorandum may be one means of permitting members to change the constitution to further individual interests in a way not agreed by all members on the formation of the company. This may be at the expense of other members and third parties. However, it is equally important to consider some of the other means that may be used to the same effect without formal alteration of the constitution⁶⁷. These include supplementary contracts which are enforceable outside company law but still affect the joint venture company. This means can be used so long as the memorandum is drafted in such a way as to accommodate them⁶⁸.

As a result of trying to comply with the restrictions on alteration without at the same time jeopardising the future prospects of the company, an analysis of several memoranda of association of joint venture companies being formed in Tanzania reveal that the objects set out are very wide and extensive. They include objects which are not negotiated by the members. In this sense, the memoranda are divorced from their joint venture context. This kind of memorandum may affect

⁶⁴Section 5 of the Act provides for the alteration procedure.

⁶⁵See Pennington *supra* n.25, Ch. 3.

⁶⁶Namely, those which enable the company, (a) to carry on its business more economically or more efficiently, (b) to attain its main purpose by new or improved means, (c) to carry on some business which under the existing circumstances may conveniently or advantageously be combined with the business of the company, (d) to engage or change the local area of the company, (e) to restrict or abandon any of the objects, (f) to sell or dispose whole or any part of the company's undertaking, (g) to amalgamate with any company. However, under subsection 2 the alteration has to be confirmed by the court in order to have any effect.

⁶⁷As far as the English Company Law is concerned, minority members may challenge the decisions of the majority if the latter try to force in the constitution their individual interests, see our discussion *infra* pp. 119 - 122. The Tanzanian Companies Ordinance does not have provisions on minority shareholders protection.

⁶⁸It may be argued that one of the reasons why there are supplementary agreements is that unlike the constitution, these agreements are more flexible, they can be altered by parties according to the agreed formula, without any restriction by Company Law. See further Linklaters and Paines, Joint Ventures, (1990), London: Longman, p. 49.

parties who are not properly informed *ex-ante* about the future prospects of the venture. On the other hand, since negotiation of the objects in the memorandum is restricted only to the *ex-ante* negotiation, it may warrant early termination of the joint venture, when the party who was not properly informed *ex-ante*, discovers that some clauses in the memorandum need to be altered to maintain the balance of interests in the venture but that the law does not allow that⁶⁹.

While company law may restrict the alteration of the memorandum of association it allows the alteration of articles of association, subject to provisions in Companies Acts⁷⁰ and conditions contained in the articles. Therefore, a company cannot deprive itself its statutory power to alter its articles, unless a clause is contained in the memorandum of association to that effect⁷¹. Further, case law has emphasised that the alteration should be in the interests of the company as whole and not prejudicial to the interests of the minority⁷². This position is maintained even if a member has an extrinsic contract with the company which refers to or is referred to by the constitution⁷³.

When the alteration of the articles of the joint venture company is considered from the point of view of this legal position, some important questions arise. The first question is how the alteration of the joint venture company's articles should be effected in the joint venture, given that the mode of voting to pass the resolution to alter the articles may be easily blocked⁷⁴.

Parties to the joint venture company include in the articles or in shareholders' agreements rights which enable them to actively participate in all affairs of the company. In these companies unanimity, rather than majority rule, is the norm. Provisions which give loaded voting rights, or which require each shareholder to have a representative in the board with a blocking vote are common⁷⁵. Although these provisions may have the effect of barring the company from exercising its statutory power to alter its constitution *Bushell V Faith*⁷⁶ held that they may be enforceable against the company. However, according to *Russell V Northern Bank Development*

⁶⁹More discussion on Termination of Joint Venture Companies is provided *infra*, pp. 161 - 165.

⁷⁰See sections 9 and 17 of the English *Companies Act*, and section 12 of the Tanzanian *Companies Ordinance*.

⁷¹Section 9 of the English Companies Act and section 12 of the Tanzanian Companies Ordinance; See also Farrar *supra* n. 2 at pp. 128 - 130; *Read V Astoria Garage Ltd.* [1952] Ch. 637.

⁷²*Brown V British Abrasive Wheel Co.* [1919], 1 Ch. 290; *Dafen Tin Plate Co. Ltd. V Llanelly Steel Co.* [1920] 1 Ch. 154, C.A.

⁷³For example, management contracts, see *Southern Foundries (1926) Co. Ltd. V Shirlaw* [1940] A.C 701 H.L.; However, this does not mean that the aggrieved party may not sue for damages under the general principles of contract law, see *Cumbrian Newspapers Group Ltd. V Cumberland & Westmorland Herald and Newspaper Printing Co. Ltd.* [1986] 3 W.L.R, 26, at pp. 43 - 44 per Scott J's obiter.

⁷⁴Refer to our discussion on deadlock shareholdings *infra* pp. 113 - 116.

⁷⁵Sometimes known as '*Bushell V Faith* Clauses', see our discussion in chapter six *infra* pp. 234 - 238 and appendix 1.

⁷⁶[1969] 2 Ch.438.

Corporation⁷⁷, provisions in the shareholders' agreement which explicitly bar the company from altering its constitution may not be enforced against the company, but may be enforced against shareholders *inter-se*⁷⁸.

When this interpretation is applied to the alteration of the constitution of the joint venture company problems arise. Because of the need to preserve mutual interests and common control it is likely that shareholders will continue to agree on limiting the company's power (in fact each others' power) to alter the joint venture company's constitution. In closely held corporations such as joint venture companies the shareholders' agreement may have same effect as that of the constitution⁷⁹. Thus, allowing the enforcement of the shareholders' agreement which bars the company from exercising its statutory power to alter its constitution against shareholders, amounts to the legalisation of a fetter of corporate power to alter its constitution in the joint venture-type company. However, in these companies the fetter may be justified because of the fact that provisions which limit the power of the company to alter its constitution are necessary to maintain joint control and active participation of every member⁸⁰.

The second problem arises from the fact that company law allows only shareholders (members) to participate in the alteration of the articles⁸¹. This, to some extent, is unrealistic, especially as far as joint venture companies in developing countries are concerned. As we saw when discussing supplementary contracts, *de-facto* alteration may be occasioned by the directors or management as they can enter into contracts which have the effect of altering the articles of the company⁸². The non-involvement of these important actors in the process of alteration of the articles may render the good intention behind alteration questionable. Gower⁸³ proposes that section 14 of the Companies Act has to be re-drafted 'so that it says that the memorandum and articles constitute a contract between the company, its members, directors and other officers...' This is more important in the constitution of the joint venture companies being formed in developing countries

⁷⁷ [1992] 1 W.L.R 588.

⁷⁸ According to Lord Jauncey *supra* n. pp.594.

⁷⁹ Because they are entered into by all shareholders, according to *Cane V Jones* [1980] 1 W.L.R, 1451, resolutions passed through these agreements are as good as those passed through the constitution.

⁸⁰ See Gower *supra* n. 6 p. 154; See also Schmithoff C. 'House of Lords Sanctions Evasion of Companies Act' *J.B.L.* [1970] 1, at p. 2; When one considers this fact together with the fact that loaded votes rights or golden shares will continue under the current wave of privatisation and formation of joint venture companies, (see Gower *supra* n. 6 at p. 77), proposals for the relaxation of the rule against fetter of the corporate power to alter its constitution, as far as closely held corporations are concerned, may be considered.

⁸¹ Because the alteration has to be made by shareholders' special resolution in a General Meeting. Managers and employees have to acquire shares in order to participate in this meeting to protect their interests as managers or employees.

⁸² See our discussion on supplementary contracts *supra* pp.94 - 97.

⁸³ *Supra* n. 6 at p. 228: Xuereb Peter, *Rights of Shareholders*, (1990), Oxford, BSC Professional, Books., at p. 5.

where the providers of managerial skills and technology play an important role in maintaining the legal structure of the venture.

4:3:3. *THE JOINT VENTURE COMPANY AND THE DOCTRINE OF ULTRA-VIRES.*

One of the circumstances which show that the company is different from a natural living person is its capacity to act in its own personality. An individual person, of sound mind who has attained the age which gives him or her legal capacity to enter into different transactions cannot have his or her acts invalidated for lack of capacity⁸⁴. On the other hand, the actions of the company after registration can be invalidated in some circumstances through the doctrine of *ultra-vires*⁸⁵. Transactions that involve the company are regarded as involving three parties namely: the company (normally regarded as the principal), one who acts on behalf of the company (sometimes called the agent) and the other party to the transaction (normally regarded as the third party). However these parties are referred to, this study proceeds on the basis that it is important to understand when the transactions between these parties should be between the company (i.e., a unifying term of overlapping interests of incorporators) and the third party and when it should be between those who are supposed to act on behalf of the company in their capacity as individuals and the third party. It is in the latter sense that it is proper to call the other party to the transaction 'the third party', when looked at in relation to the company⁸⁶. It may be arguable that the modern version of the doctrine of *ultra-vires*, as will be described below, has proceeded from this understanding.

The doctrine of *ultra-vires* was developed to invalidate transactions which the company entered beyond its capacity as provided in the objects of the company⁸⁷. This doctrine is sometimes used to refer to situations where those who act on behalf of the company, go beyond or outside the powers they are given by the constitution of the company⁸⁸. Therefore, the doctrine can be used

⁸⁴However, this is subject to the factors in contract law which may 'incapacitate' a person to contract. For example, mental disability, intoxication and bankruptcy.

⁸⁵The literal meaning of the phrase is: 'beyond powers' (see Black Law Dictionary). But in this context it denotes 'acts beyond the scope of the powers of the corporation'. As discussed below these powers may be determined by the corporation charter, corporation law, or what those who act on behalf of the corporation are required to do. See Pennington *supra* n. 25, at pp. 91 - 92.

⁸⁶This is because in the relational sense those who act on behalf of the company are a part of the company itself when the corporation is construed to mean not only shareholders, but the overlapping interests of all corporate actors. In this sense it is those interests which are beyond overlapping interests which should be regarded as *ultra-vires*.

⁸⁷Gower *supra* n. 6, Ch. 8; Farrar *supra* n. 2, at pp. 91 - 104.

⁸⁸Gower *ibid.* pp. 166 - 167.

in three senses. It can be used strictly to refer to whether the company has a legal capacity to act. This sense concerns issues of corporate personality which we have discussed in the previous chapter. The second sense refers to those who act on behalf of the company when they exceed their authority as provided for in the company's constitution. The doctrine may also apply in the third sense to refer to actions by the company which go beyond the law.

The English position as regards the doctrine of *ultra-vires* has changed significantly. The classical position of the doctrine which was enunciated in *Ashbury Railway Carriage and Iron Co. Ltd. V Riche*⁸⁹ has been modified greatly. In that case Lord Cairns was of the view that if the constitution of the company stated affirmatively the ambit and extent of vitality and power which by law are given to the corporation, it impliedly (or sometimes expressly) states or means that nothing should be done beyond that ambit and that no attempt should be made to use the corporate life for any other purpose than that which is so specified⁹⁰. This meant that any transaction beyond the memorandum of association of the company was void and no party could enforce it.

It has been argued that the above approach was based on the artificial entity theory. That incorporation being a privilege which is only granted in respect of the objects specified in the constitution is not to be abused by disobeying the constitution which is the basis of the grant⁹¹. One of the factors which caused the basis of the theory to be doubted was that it did not put into consideration the fact that the corporation exists through the actions and in the interests of its constituencies - shareholders, directors, employees and creditors. Arguably some of several problems which have led to the reform of the doctrine can be attributed to this failure.

It is obvious that the doctrine could function properly only if the right of the members of the company to alter the constitution of the company is restricted. Otherwise the argument that it is only those objects which were in the constitution at the time of incorporation which express the capacity of the company fails. Therefore, when it was recognised that the real capacity of the company is determined by the continuous negotiation taking place from time to time within the company, the 1948 English Companies Act was amended to allow members to alter the constitution of the company. This rendered the artificial entity basis for justifying the doctrine questionable. Indeed, proposals to abolish it were suggested⁹².

⁸⁹[1874-80] ALL ER Rep. Ext. 2219; (1875) L.R. 7 (H.L.), 653.

⁹⁰Ibid. at p. 170.

⁹¹See Farrar supra n. 2 at p. 103; Pennington supra, n. 25, at p. 92; *Attorney General V Great Eastern Railway Co* (1880) 5 App. Cas. 473; Stephen Bottomley 'Taking Corporation Seriously: Some Considerations for Corporate Regulations', 19 *Fed.L.Rev.* (1990), 203, at p. 208; Mary Stokes, 'Company Law and Legal Theory' in Twining W. (Ed) *Legal Theory and Common Law*, (1986), New York, Basil Blackwell. 155, at p. 162; Horwitz M. 'Santa Clara Revisited: The Development of Corporate Theory' 88 *W. Virg.L.Rev.* 173, at p. 186.

⁹²See for example, the Cohen Committee Report, 1945 Cmmd. 6659, para 12; *The Jeikin's Committee Report*,

The second threat to the doctrine was posed by those who drafted the objects clause. Being motivated with the need to draft objects which did not limit the business of the company, and through that, attract subscribers to the company, object clauses were drafted so as to give the company the capacity to do almost everything⁹³. As a result of the ingenuity of drafters, it became increasingly unfair to assume that those who traded with the company would know the capacity of the company (constructive notice)⁹⁴. Difficulties in the application of the classical doctrine of *ultra-vires* have culminated in amendment to the English Companies Act which reflect the relational approach.

The 1989 amendment to the Companies Act, 1985 has the effect of abolishing the classical view that the capacity of the company is determined by the memorandum of association⁹⁵. No act of the company can have its validity questioned on grounds of lack of capacity⁹⁶. This applies to all persons without the need to show good faith and can apply in favour of the company itself. Further, it recognises that the company exists through the actions of its constituencies, in particular the directors, who are given power to represent other constituencies (the company). They are supposed to act according to the limitations of the company's capacity as provided for in the memorandum of association and they are liable if they do not act accordingly (i.e., when they engage in *ultra-vires* activities). However, those activities can be ratified by a special resolution and so they amount to the alteration of the constitution of the company⁹⁷. Thus, what determines what is *intra-vires* is the agreement between corporate actors which is continuously negotiated.

The amendments also continue to preserve the rights of any shareholder (in reality, the minority shareholder) to take a court action to challenge the transaction by the directors which are beyond the capacity of the company⁹⁸.

1962 Cmmd. 1749, paras 35 - 42; See also Wedderburn, K.W. '*Ultra-Vires* in Modern Company Law' 46 *M.L.R.*, (1983) pp. 204 - 213.

⁹³By inserting general objects clauses such as: 'to carry on any other trade or business whatsoever which can, in the opinion of the board, be advantageously carried on by the company in connection with or ancillary to any of the above businesses or the general business of the company...' (Obtained from a Clause of the Memorandum of Association of one of six joint venture companies studied in our research, the detail of which is provided in chapter six *infra*, pp 225 - 233.); See also *Bell Houses Ltd. V City Wall Properties Ltd.* [1966] 2 Q.B 656, C.A and *Newstead V Frost* [1980] 1 W.L.R 135 H.L which discussed the issue of general object clauses.

⁹⁴Gower *supra* n. 6 at pp. 170 - 185.

⁹⁵Section 35(2&3) of the *English Companies Act*. (1985) as amended in 1989.

⁹⁶See section 35(1) of the Act.

⁹⁷*Ibid.* See also our discussion on alteration of the company's constitution, *supra* pp. 120-122.

⁹⁸Section 35(2) *supra* n. 95; See also Nigel H. Bastin, 'The Enforcement of Members Rights', *J.B.L.* [1977] 17, he analyses the concept of individual rights in taking court actions vi-a-vis collective rights.

Finally, although the amendments are aimed at protecting those who deal with the company, the protection against fetters on board authority only extends to those who act in good faith and it cannot be used by the company. If the third party acts in good faith, the power of the board to bind the company, or to authorise others to do so, is not limited by the company's constitution⁹⁹.

Therefore, one may argue that as far as the English position is concerned, the doctrine of *ultra-vires* has been modified rather than abolished¹⁰⁰. Because although a company, as a group of individuals, could be deemed to have all the capacity of a natural person, it will still have to act through individual agents who may put individual interests over those of the group if not controlled. Nevertheless, the changes which have been made enable the doctrine to meet the requirements of more complex business organisations like joint venture companies.

The Tanzanian position is still equivalent to that found in the British 1948 Companies Act. This is because the Tanzanian Companies Ordinance still restricts the amendment of the memorandum of association¹⁰¹. Further, no provision in the Ordinance prohibits a challenge to the capacity of the company based on its memorandum of association. Again, the constructive notice rules still apply¹⁰². Therefore, it may be argued that subject to some flexibility provided by case law, the classical doctrine of *ultra-vires* still applies to companies being formed in Tanzania including joint venture companies. The major issue is how the doctrine affects the formation and the operation of joint venture companies.

As argued in the second chapter of this study, a joint venture company is formed by parties with interdependent objectives. These objectives have to be included in the memorandum of association of the company in order to reflect the interests of the parties. However, this does not mean that these objects will remain in the same interdependent or complementary state. Since they are continuously negotiated by the company's constituencies they are bound to change. In order to keep these objectives in the interdependent zone, they have to be changed according to the movements of each negotiator¹⁰³. In this sense the rules that restrict the company's power to alter its objects may affect the structure of the joint venture company when the negotiation within the company has changed the objects but the objects set out in the memorandum remain as negotiated *ex-ante*. This may occasion movements from interdependence to dependency, leaving the

⁹⁹Section 35 A (1) & (2) *supra* n. 95. In this sense, directors may be liable if transactions with the third party who acts in good faith are not sanctioned by the general meeting.

¹⁰⁰This is because these amendments do not amount to giving full and unlimited capacity to the company like that of a natural person, see Pennington, *supra* n. 25 at p. 97.

¹⁰¹*Supra* pp. 97 - 100.

¹⁰²Following the Common Law position in, *Royal British Bank V Turquand* (1856) 5 E&B 248, 24 L J Q B 327, 1 Jur. NS 1086.

¹⁰³See our discussion in chapter three pp 85 - 94, 102 - 105.

unaltered memorandum portraying the wrong structure of the joint venture company.

Therefore, it may be concluded that the current English position of *ultra-vires* is based on the relations between the organs of the company rather than on the memorandum of association. It may thus be applied to joint venture companies with some success. If the position of Tanzanian company law is not modified to that effect, problems must be anticipated in applying the doctrine to joint venture companies.

4:4. JOINT VENTURE COMPANY'S INTERNAL RELATIONS AND THE LAW.

4:4:1. GENERAL LEGAL CONSIDERATIONS.

A company, though a legal person, cannot act in person. Its policy has to be formulated and decided upon by individual human beings and can be put into effect and carried out only by human agencies. As discussed in the third chapter, despite the fact that a company exists through human agencies, a popular version of the classical company law theories regards the company as residing in the body of shareholders only. The legal entity approach insists on the corporate entity as 'something' real or artificial in order to protect the individual interests of shareholders¹⁰⁴. This results in a lack of a precise determinant of the company and those composing it. The aggregate of contracts approach also disregards the existence of the corporate entity for the same purpose of trying to protect the interests of shareholders. But again, it involves itself in conceptual problems by failing to explain why a corporate contract is essentially different from normal contracts, the fact which necessitates the existence of a corporate entity¹⁰⁵. This Part seeks to use the relational approach to analyse the internal relations of corporate actors, with the objective of applying the analysis to relations within the joint venture company.

After an, at times reluctant, acceptance of the view that corporate membership is not limited to shareholders, efforts are under way to try to analyse the role of shareholders in the context of other relations within the corporation¹⁰⁶. The general argument is that if a company is to be

¹⁰⁴See our discussion in Ch. 3 *supra* pp.54 - 60.

¹⁰⁵*Ibid.* pp. 60 - 66..

¹⁰⁶John Clark, 'Juridification of Industrial Relations', 14 *I.L.J.* (1985), 69; Xuereb G. Peter, 'The Juridification of Industrial Relations through Company Law Reform', 51 *M.L.R.* (1988), 156; Kahn-Freund Ott, 'Industrial Democracy', 6 *I.L.J.* (1977), 65; Simitis, 'Workers Participation in the Enterprise' 38 *M.L.R.* (1975), 1; Schmitthoff, M. Clive, 'Employees Participation and Company Structure', *J.B.L.* [1976], 88; Corton L. 'Employees Participation in Swedish Company Law', *J.B.L.* [1975], 163; Neil Martin Kaye, 'Theoretical Basis of the Modern Company Law' *J.B.L.* [1976], 235.

regarded as an economically independent unit or as an enterprise¹⁰⁷, all interest groups, particularly, shareholders, management and employees, should be regarded as a part of it¹⁰⁸. Generally, while it is accepted that orthodox company law theories have dealt, to some extent, with the protection of the interests of shareholders, the interests of employees have been forgotten in that management, which has been taken to occupy a strategic position in this relationship, is required to act in the interests of shareholders only¹⁰⁹.

This study argues that it is in the efforts to balance the interests of shareholders and employees against those of the managers that the existence of the company may be inferred¹¹⁰. This is because as argued in the third chapter, while members of each constituency of the company have individual interests which they intend to realise through the company, they have at the same time co-operative interests in the company which are based on continuity in the realisation of individual interests. Paradoxically, it is when short-term interests of an individual member or a group are considered in relation to those of others that long-term interests develop. It is against this background that the rights and duties which company law accords to each and every member of the constituencies will be analysed.

4:4:2. *SHAREHOLDERS RELATIONS.*

Just as the number and types of business organisations increase, the types and differing interests of shareholders within a single business organisation increase with the effect of making it impossible to classify them as a single group representing the same interests¹¹¹. Further, shareholders of modern business organisations are no longer individual persons. The number of institutional and corporate shareholders has increased rapidly. Institutional shareholders account for well over 50 per cent of share-holdings in companies in the United States as well as listed companies in the

¹⁰⁷See the meaning of an enterprise as discussed in chapter three *infra* pp. 76 - 77.

¹⁰⁸In particular see Farrar J.H "The Duty of Controlling Shareholders", in Farrar (Ed.) Take-overs: Institutional Investors and the Modernisation of Corporate Law, (1993), Auckland: Oxford University Press, pp.383 - 384; Xuereb *supra* n.106, at pp. 156 - 157.

¹⁰⁹See Xuereb 51 M.L.R. *supra*, n.106, at p. 157; Ralph Instone, 'The Duty of Directors' J.B.L. [1979], 221; See also the argument in Hutton V West Cork Railway Co. Ltd. (1883), 23 Ch. D 654; Re Smith and Fawcett Ltd., [1942] Ch. 304, at 306; See generally, Wedderburn of Cherton, 'Companies and Employees: Common Law or Social Dimension?', 109 L.Q.R. (1993), 220. Of course, this is subject to section 309 of the Companies Act which has been introduced to protect the interests of employees the implications of which will be discussed shortly.

¹¹⁰See our discussion in chapter three *infra* pp. 33 - 77; See also Farrar H. J *supra*, n 108, at pp. 383 - 384 he says: 'To understand the company, it is necessary to disregard the fiction, and have regard to the underlying interests in the fund. The principal interests are those of shareholders, employees (including the management) and creditors'; See also Wedderburn *ibid.* pp. 230ff.

¹¹¹Xuereb, Peter, The Rights of Shareholders, (1989), Oxford: BSP Professional Books, pp. 5 - 7.

United Kingdom¹¹². When institutional shareholders extend their tentacles beyond their countries of domicile, another division of interests should be anticipated between host shareholders and foreign shareholders. To a greater extent, joint venture companies which are formed in developing countries, represent this characteristic of share- holding. Therefore, the company law of host countries not only face the problem of institutional shareholders, but also of how to contain the foreign as well as the local interests of the shareholders.

In company law there are various means through which a company (or an individual) can acquire membership in company¹¹³. However, membership of the company is only recognised when it is acquired through share-holding. As a result of the modern developments in the structure of the company, other constituencies like managers or employees who are influential in the operation of the company are allowed, offered or sometimes required, to acquire shares in the company by virtue of being employed by the company¹¹⁴. Although this may be a step in the right direction, it does not amount to the recognition of these constituencies as members of the company in their own right.

As observed elsewhere, shareholders' rights stem partly from the company's contract (i.e. company's constitution) and, partly, from company law¹¹⁵. Shareholders' statutory rights may be exercised as a whole group, as a class or as individuals.

Individual (personal) shareholders' rights.

Shareholders may have their individual rights included in the company's constitution, in which case they can enforce them against other members or against the company. Apart from these rights, shareholders have individual rights which are provided by company law. These include the right: (i) to receive dividends which have been duly declared or which have become due under the terms of the articles of association¹¹⁶; (ii) to have capital returned in a proper order when the company is wound up¹¹⁷; (iii) to restrain the company from doing acts which are *ultra-vires*¹¹⁸; (iv) to have a reasonable opportunity to speak and vote at meetings of members and move

¹¹²Ibid. pp. 5 - 6; William Tylor, 'Can Big Owners Make a Big Difference?', Harv.Bus.Rev. (1990), 70, who notes that Institutional Investors rose from 47% in 1975 to 63% in 1991.

¹¹³Morse Geoffrey, (Ed.), Palmer's Company Law, (1992), (25th edn.), London: Sweet and Maxwell, para 7.

¹¹⁴Through what are known as employees share schemes, see Gower supra n. 6, pp. 364 - 365; See also sections 94(4), 101(2) and 743 of the English Companies Act.

¹¹⁵Supra pp. 90 - 94.

¹¹⁶Wood V Odessa Waterworks Co. (1889), 42 Ch. D, 636.

¹¹⁷Griffith V Paget, (1877) 5 Ch. D, 894.

¹¹⁸Simpson V Westminster Palace Hotel, (1860), 8 H.L. Cas., 712; Hoole V Great Western Railway, (1867), 3 Ch. App. 262, at 277; See also section 35(2) of the English Companies Act.

amendment(s) for resolutions moved at such meetings¹¹⁹; (v) to transfer shares¹²⁰; (vi) not to have their financial obligations to the company increased against their wishes or consent¹²¹; (vii) to inspect various documents and registers kept by the company¹²²; (ix) to have share certificates issued to them in respect of their shares, and; (x) to appoint proxies to vote on their behalf at meetings of members¹²³.

Some personal rights are necessary to an individual but are not so provided by law and not specifically included in the constitution of the company. In such cases, the dividing line between corporate and personal rights may be very hard to draw. Especially when the "personal rights" are those of a corporate shareholder¹²⁴.

Class Rights.

Between individual personal rights and corporate rights of shareholders there are what are known as class rights. These are exercisable by a particular class of shares or a particular class of shareholders. One class of shareholders may be allotted shares out of the share capital of the company and can exercise such rights and privileges against other shareholders. This position is supported by the company law of both England¹²⁵ and Tanzania¹²⁶. Formerly, these rights were only exercisable in determining the priority in the payment of dividends or residual capital when the company was wound up¹²⁷. But nowadays, especially after the liberal interpretation in the case of *Cumbrian Newspapers Group Ltd. V Cumberland & Westmorland Herald Ltd.*¹²⁸, it seems class rights are recognised even though these rights are attached to shares with the same priority in the payment of dividends. For example, additional voting rights of one or more shareholders can be recognised as class rights and therefore be protected against other shareholders. This facilitates the attachment of special rights to some shares with 'special weight' in voting¹²⁹. As it will be discussed shortly, the extension of company law to such classes of shares helps to cater for the rights which are given to shareholders in the joint venture company.

¹¹⁹*Wall v London and Northern Assets Corp.* [1898] 2 Ch. 469; *Henderson V Bank of Australia*, (1890), 45 Ch. D, 330.

¹²⁰*Re Smith Knight Co.* (1868) 4 Ch. App. 20.

¹²¹*Hole V Garnsey* [1930] A.C, 472; See also section 16(1) of the English Companies Act.

¹²²Pennington supra n. 25, at p. 651.

¹²³*Ibid.*, at p. 651.

¹²⁴Pennington *Ibid.* at p. 651; See also *Prudential Assurance Co. Ltd. V Newman Industrial Co.* [1981] Ch. 204, at pp. 222 - 223, where it was made clear that when loss is suffered by the company, an individual member cannot bring action against those who caused it on the ground that the loss occasioned a diminution in value of its shares.

¹²⁵Sections 125 - 127 of the English Companies Act (1989); Generally, see Gower supra n. 6, pp. 536 - 547.

¹²⁶Section 62 of the Tanzanian Companies Ordinance.

¹²⁷For example, preferred and deferred share rights, see Farrar, supra n. 2 at pp. 221 - 234.

¹²⁸(1987) 1 Ch. 1 at p. 20.

¹²⁹One type of this share known as the golden share is used to limit the power of public enterprises (government) after their privatisation. See our discussion in chapter two supra p. 25.

Shareholders' group (company's) rights.

Apart from having individual or class interests, shareholders have group or community interests which are widely referred to as company interests. The recognition of corporate rights within the company was expressed in *Foss v Harbottle*¹³⁰. The case gave a justification for two interrelated principles in company law. The first principle is that the court will not interfere with the internal management of the company when acting within its powers. The second emphasised the existence of group or company interests and their protection. It insisted *inter alia* that, in order to redress the wrong done to the company, the action should *prima facie* be brought by the company itself, not an individual member(s)¹³¹.

However, the fact that the company, though a legal entity, has to act through individual agencies, was one of the obstacles to this doctrine. The ultimate decision by the company was based on democratic principles which vested the decision of the company in the majority members¹³². The majority decision represented the decision of the company notwithstanding the fact that the majority may use the corporate entity to further their individual interests. Conversely, the circumstances in which the minority were allowed to institute proceedings whether on behalf of the company or on their own behalf were regarded as exceptions to the general rule¹³³.

The principles in the above doctrine and the theories which support them failed to recognise the fact that the company as an entity does not exist in a vacuum. It exists primarily in the relationship between all the actors of the corporation, whether majority or minority, shareholders or employees. *Foss V Harbottle* cannot be fitted in the concept of a company as an independent entity without difficulty. The moment this is attempted, the issue arises of whether the management can cause the company to sue or fail to sue for matters which are *intra-vires* the company, despite the resistance of the majority shareholders. These problems have been experienced in England in the case of *Prudential Assurance V Newman Industries*¹³⁴.

Secondly, the doctrine ignored the fact that it is the members' overlapping interests which express the existence of the company and which if exercised, are the ones which should determine whether the company should take a court action or not. The court action by the company (as a

¹³⁰(1842) 2 Hare 461.

¹³¹Ibid. See also *Mozley V Alston*, (1847) 1 Ch. 790. A detailed discussion about these propositions is provided by Wedderburn K.W, 'Shareholders Rights and the Rule in *Foss V Harbottle* supra n. 27.

¹³²*Re Transvaal Gold Exploration Co.*, (1885) 1 T.L.R., 604.

¹³³Wedderburn, supra n. 27; Pennington supra n. 25 at pp. 654 - 658.

¹³⁴[1981] Ch. 204. In fact sometimes courts have found it difficult to apply the rule in *Foss V Harbottle*, for example in the *Prudential Assurance* minority shareholders were allowed to sue on behalf of the company for wrongs done by directors. See further discussion on this issue infra pp. 119 - 122.

plaintiff) is appropriate if the overlapping interests have been affected or are in danger of being affected. Overlapping interests are determined when the individual interests of each member are considered in relation to the interests of others. Thus, when there is a unanimous decision by all the members, it means that there is a small difference between individual interests and overlapping interests. As the overlapping interests of a member decrease its individual interests increase. Hypothetically therefore, majority shareholders are more concerned with overlapping interests in the company than individual interests and minority shareholders are more concerned with individual interests in the company than corporate interests. While this may be regarded as a general rule or as a justification of *Foss V Harbottle*, it may be found in some instances that the majority decision or view is made in order to further its individual interests and the minority view is the one which furthers the interests of the company. It is in these circumstances that it is proper to apply exceptions to the rule in *Foss V Harbottle*. For example, in *Daniesl V Daniels*¹³⁵ the majority shareholders (a couple) who were also directors of the company decided to sell the company's land to one of them (the wife), at a price which they knew or ought to have known that was an under-value. The land was later sold at a value which was about three times higher than the buying price. The minority shareholder's claim that the sale was not in the interest of the company but in the individual interests of the majority shareholders succeeded. It was held *inter alia* that the exception to the rule in *Foss V Harbottle*, enabling a minority shareholder to bring action against a company for fraud where no other remedy was available should include cases where although no fraud was alleged, there was a breach of duty by directors and majority shareholders to the detriment of the company, but to the individual benefit of the majority shareholders.

Exceptions.

Jenkins L.J in the case of *Edwards V Hallwell*¹³⁶ gave four exceptions to the rule in *Foss V Harbottle*, namely: (i) When the act complained of is wholly *ultra-vires* or illegal; (ii) where the matter is the one which could validly be done or sanctioned not by a simple majority of the members but only by a special majority; (iii) where the personal and individual rights of members have been invaded; and, (iv) where what has been done amounts to what is generally called fraud on the minority and the wrongdoers are themselves in the control of the company¹³⁷.

When these 'exceptions' are considered from the of view of the relational approach as discussed above, it may be discovered that only the last exception is a true exception to the rule. The first

¹³⁵[1978] Ch. 406, pp. 413 - 414.

¹³⁶[1950] 2 ALL ER 1064 C.A, at p. 1067.

¹³⁷Ibid. at p. 1067; See also *Burland V Earle* [1902] A.C 83, at pp. 93 - 94; *Northwest Transportation Corporation V Beatty* (1887) 12 App. Cas. 589.

three are not, because any attempt by the majority to deprive the minority of the right to take a court action in situations where those exceptions are involved, is void not because of the rule in Foss V Harbottle, but because other rules have already so provided. But the fourth exception is a true exception because it includes some of the circumstances which prove that the majority were motivated by individual or personal interests, the interests which do not overlap with the interests of other members (the minority). In other words, in justifying minority action on behalf of the company, despite resistance of the majority, the minority have to prove that when their interests are considered in relation to the interests of the majority, the overlapping interests are in danger if the court action is not taken¹³⁸. Thus, by using the relational approach one may suggest a general rule that any actor of the company whether a shareholder, manager or employee should be allowed to sue on behalf of the company, provided it proves that the interests of the company are in danger. This should not only be limited to the proof of fraud on the minority¹³⁹ because the categories of this exception are never closed¹⁴⁰.

Joint Venture Company's Shareholders.

Share-holding in the joint venture company differs from that in other companies, because of the following features:

Firstly, share-holding in a joint venture company involves companies with compatible or complementary interests, to the extent that they consider themselves as 'partners', and wish to conduct their business as partnerships¹⁴¹. In other words, if the existence of joint venture companies is not based on the fact that joint venture companies sometimes involve more complex and more risky business operations which need large contributions of capital assets, know-how

¹³⁸See Farrar supra n. 108, at p. 388; See also the argument by Sir Robert Megarry VC in Estmaco (Kilner House) Ltd. V Greater London Council [1982] 1 W.L.R 2 at p. 16 he notes that: 'No right of a shareholder to vote on his own selfish interests or to ignore the interests of the company entitle him with impunity to injure his...fellow shareholders by depriving the company of a cause of action and stultifying the purpose for which the company was formed' (my own emphasis)

¹³⁹The court in several instances has tried to expand it. See for example, Clemens V Clemens Bros. Co Ltd. [1976] 2 ALL ER 268; Burland V Earle, supra n. 137.

¹⁴⁰According to Vinelott J in Prudential Assurance, supra n. 134, at p. 317: '...it is unnecessary... to decide precisely where the boundary limiting the category of cases which permit minority shareholders's action....'. Indeed, according to Barnes D. Kiser, in 'Justice Survives Foss V Harbottle Rule', 8 Co Law (1987), 92 - 94, the Nigerian Case of Edokpolo & Company V Sem-Edo Wire Industries Ltd. (1984) 7 SC 119 has developed a fifth category of exception: that the rule cannot apply in situations where it is invoked to defeat means of justice; See also Edwards V Hallwell [1950] 2 ALL ER, 1064 at p. 1067 where Jenkins L. J was of the view that there is an exception from the rule whenever the justice of the case requires it; Megarry supra n. 132 at p. 11 is of the view that justice is a reason for the exception, not the exception itself; See also Daniel V Daniel & Co. Ltd [1978] Ch. 406, at p. 414 Templeman J added the notion of negligence to the categories of exceptions.

¹⁴¹Afterman Allen, B. Company Directors and Controllers: Their Duties to the Company and Shareholders, (1970), Melbourne: Law Book Co. at p. 8

and goodwill from the members, one may regard joint venture companies as 'small or family companies' or 'quasi-partnerships'¹⁴².

The second difference is found in what makes shareholders of a joint venture company members. Whereas in other companies the acquisition of shares through non-cash contributions may be regarded as an exception to the norm¹⁴³, in joint venture companies, shares are acquired mostly through non-cash contributions. Shares in the joint venture company may be acquired through the contribution of managerial skills and technical know-how or sophisticated assets which are accompanied by the participation of the supplier to operate them. This kind of share acquisition may also apply to employees of parent companies with such technical know-how through service contracts¹⁴⁴. Therefore, a company may become a member of another company (a joint venture company), by virtue of the mere contribution of managerial skills or technical know-how. Since these contributions are not recognised by law as things which can entitle someone to become a member of a company without acquiring shares in it, their contributors have to be offered some shares and/or contributions have to be valued in monetary terms to enable them to acquire membership rights. This study argues that managerial skills as well as technical know-how, just like money (capital), are a type of property, capable of being sold, invested and generating surplus to those who invest them in other companies. Thus, they deserve recognition and protection in their own right like that accorded to other investors (shareholders and creditors).

Further, in closely held corporations the size or the structure of business organisations such as joint ventures should not be based on the number of shareholders or the nominal value of share capital or shares in the company. In this type of company the business of the company may be big while the number of shareholders will normally be small, representing only those parties with complementary interests and common control. It is therefore the nature of the business - its complexity, the risk involved, the managerial skills and technology required, and the availability of the minimum capital necessary to start the business, etc. - which are important. While small businesses or family businesses are formed by a few individuals or family members who do not

¹⁴²See for example Elizabeth, supra n. 1 at pp. 40 - 42. At p. 40 she notes that quasi-partnerships may be regarded as subsets of joint ventures; See further Corcoran S. & Toker J. 'Joint Ventures and Fiduciaries', 2 *Corp. & Bus. L.J.* (1989) 34; For the meaning of a quasi-partnership see Lord Wilberforce in the case of *Ebrahimi V Westbourne Galleries Ltd.* [1973] A.C 360, at pp. 379 - 380 where he was of the view that a quasi-partnership is used to refer to a company which in its form and its dealing with the outside world operates as a company, but which functions along partnership lines as far as internal relations of the participants are concerned. However, he insisted that the fact that members of the company are all active participants and operate on the basis of mutuality of interests and confidence, does not make that company to be referred to as a partnership. After registration it becomes a company, notwithstanding the internal characteristics of members. We submit that this may also be true to joint venture companies.

¹⁴³See supra p. 106 - 107.

¹⁴⁴Refer to our discussion in chapter two supra pp 9 - 28.; More discussion of these agreements is provided in chapter six infra pp. 234 - 242, see also appendix 1.

need much capital or managerial skills and technology from open markets, the business in the joint venture company may involve large companies who consider capital from markets more costly when independently sought than the cost of joining together. Similarly, because of the magnitude and the risk involved in the joint venture project markets for managerial skills and technical know-how are considered more costly¹⁴⁵ than the cost of seeking the contribution of same attributes from partners who can provide them cheaply and thereby become members. However, this does not mean that companies cannot agree to start small businesses or short-term businesses. It is in this sense that the difference between joint venture companies and contractual joint ventures or partnerships can be discovered.

Protection of Shareholders' Interests in the Joint venture company.

As discussed in the second chapter, in order for a business relationship to exist as a joint venture, that business should reflect the elements of complementarity, loss and profit sharing and joint control. One important means maintaining these elements is a proper distribution of shares and the rights which accompany them among members, to ensure that each member actively participates in the business and controls the joint venture company. These rights are normally provided in the constitution of the joint venture company. However, they may be provided in the shareholders' agreement¹⁴⁶. Several methods may be adopted to this end.

(a) The Deadlock Method.

In trying to establish a joint venture company which has the above elements, parties may wish to draft the constitution of the joint venture company in such a way that they all have equal ownership of the joint venture company. The typical company with such a structure is the deadlock company¹⁴⁷. The rationale for the deadlock model in a joint venture company is based

¹⁴⁵We showed in the second chapter that one of the reasons for joint venture establishment in developing countries is the fact that because of risks involved in such ventures, parties consider investing on their own by getting the needed capital, managerial skills and technology from the market, more costly (or non-existent in case of companies from developing countries) than adopting a joint venture method whereby the risk is shared. In fact while TNCs form JVCs to try to avoid local risks, local companies seek, through joint ventures, to obtain capital, managerial skills and technical know-how from TNCs. See our discussion in chapter two supra pp 9 - 28.

¹⁴⁶For example, in *Bushell V Faith* [1969] 2 Ch. 438 one of the articles of association protected a shareholder from removal from directorship by giving him weighted votes when deciding to remove him. Russell L.J in dismissing the challenge of the validity of this right indicated that this right can be provided in the articles or otherwise (i.e, in the shareholders' agreement). This position was later confirmed in *Russell V Northern Bank Development Corporation Ltd.* [1992] 1 W.L.R 588.

¹⁴⁷In essence, the deadlock company may be a normal company, not necessarily a joint venture company. According to the 6th edition (1990) of the *Black Law Dictionary*, a deadlock corporation in close held corporations arises when a control structure permits one or more factions of shareholders to block corporate actions if they disagree with some of the corporate policies, (at p. 398). The general view of writers has been that joint venture companies are deadlock companies, see for example, Stedman and Jones, *Shareholders*

on the entity theories which believe that share-ownership is a sole determinant of company ownership and control. Equal share-ownership therefore is an indication of joint control and equal profit sharing in the joint venture company. However, it is important at this juncture to distinguish between what is called a deadlock company based on equal share-ownership alone and a joint venture company which is based on the joint contributions of all participants, including managers and employees. In the latter context the concept of deadlock goes further to recognise contributions which are made in kind, for example, managerial skills and technical know-how. This is because in the joint venture company members may be given rights of control because they contribute managerial skills and technical know-how. A deadlock joint venture method anticipates that the contribution of each participant is crucial to the operation of the venture. If one of the participants does not play its part the whole process comes to a stand-still. Parties with compatible or interdependent interests will not disagree in any circumstances as far as the operation, and the distribution of profits are concerned. Given complementarity of interests, co-operation is guaranteed. Opportunistic temptations due to imbalances in contributions or access to information is mitigated by the danger that each party will face if the relationship is broken by its failure to co-operate. Members operate on the basis of the maxim: "unless we all co-operate we shall all fail" or that; "in order to operate we must co-operate". As a result, certain consequences flow from the use of a deadlocked joint venture company.

First, because of the fear of a deadlock the acquisition of shares (membership) in a joint venture company cannot be free to any company. In order to avoid unnecessary frustrations or premature termination, a good assessment and selection of partners is necessary. It is important that parties to the deadlock joint venture company have compatible interests. Thus, the selection of prospective shareholders is as important as the future life and success of the venture itself. This clearly shows some characteristics in the acquisition of shares which are different from other companies¹⁴⁸.

Secondly, as already discussed elsewhere, the selection of the partners may not be enough. If the constitution of the joint venture company is drafted in such a way that the rights of members are not clear and are not limited to those interests of the parties which overlap, there may be potential difficulties. An ambiguous constitution can accelerate the deadlock, the fact that the law allows its alteration notwithstanding¹⁴⁹.

Agreements, (1990), London: Longman, at p 170ff.; Brodley Joseph, 'Joint Ventures and Antitrust Policy', 95 Harv. L. Rev., (1982), 1521. This is because joint ownership and joint control of joint venture companies is premised on shared or joint ownership. As will be shown below, this study looks at the concept of joint control from a wider view, based on interdependence of all actors to the joint venture company. Therefore, the context of deadlock joint venture companies is equally differentiated from that of other companies.

¹⁴⁸. See our discussion in chapter two pp. 46 - 49.

¹⁴⁹ This is because a deadlock situation may also happen in attempts to remove the ambiguity by altering the

Thirdly, if the transfer of shares in a deadlocked joint venture company is not restricted, it may affect the nature of control of the company. However, such restrictions may themselves affect the commercial life of the company. Therefore, a deadlocked joint venture company may not always restrict the transfer of shares as some tend to think¹⁵⁰. To the contrary, transfer and issue of new shares may operate in such a way that the compatibility of interests and equal proportions of members' contributions are maintained.

The main advantage of a 50-50 joint venture company is that it may be used to counter the effect of the rule in *Foss V Harbottle* in the protection of mutual interests of all shareholders. As there is no majority shareholder, the participation of all parties in the activity and control of the joint venture company is guaranteed. However, this should be balanced against the dangers of a premature termination of the joint venture company, in cases where it becomes impossible to operate the company because of a deadlock situation.

Moreover, as argued in the second chapter¹⁵¹ it may be difficult to establish a joint venture company in which the contribution of the parties is 50-50 or equal. Further, it is not necessarily the case that contributions have to be acknowledged only by the acquisition of shares. Therefore, where the 50-50 contribution is impossible but the level of interdependence among the parties still allows co-operation, members may devise other ways of maintaining the joint venture company, despite discrepancies in the number of shares allotted or the mode of contribution to the venture.

(b) The Classification of Interests.

One of the methods used by joint venturers to achieve a joint venture company in a situation where share-ownership is uneven or unequal, is to divide members' interests, (hence their contribution) into classes. Say class 'A' and 'B', depending on the compatibility of partners' interests¹⁵². In this case, members with more or less the same interests may form one class, with rights and obligations which aimed at maintaining the balance of interests (interests equilibrium) in

constitution. On the alteration of the constitution see supra pp. 97 - 100.

¹⁵⁰Cited in Note 147 supra.

¹⁵¹Supra pp. 30 - 31.

¹⁵²In determining these classes several factors are considered. Some joint ventures consider types of contributions by the parties, i.e., those who contribute in cash may form one class and those who contribute in kind may form another class. Classes may be formed also on basis of nationality of members in cross-national joint venture companies. They may also be formed on the basis of the type of the company, for example, in a joint venture between a public enterprise (governmental) and a private enterprise, each type of enterprise may represent one class. The latter type of classes is mostly practised in developing countries under the current process of privatising public enterprises, see our discussion in chapter two supra pp 21 - 27; Classes may also be determined on the basis of the currency of contribution, e.g, contributors in foreign currency may form one class and contributors in local currency may form another, etc. See also appendix 1

the joint venture company.

Company law rules as regards class rights also apply to this kind of shares¹⁵³. However, if the constitution of the company allows transfers of shares from one class to another, the 'weight' of shares of one class may be affected. This may destroy the original balance of interests.

The most rigid way of solving this problem is to provide that each class shall collectively have one vote. This means that any differences between the holders of one class of shares have to be settled within the class and come out as a single view, probably by majority voting¹⁵⁴. This method, although it may not be acceptable to the minority shareholders because it relinquishes their rights in the general meeting, has a number of advantages.

Firstly, it ensures that the holders of the majority shares of the class in question can exercise the class vote and therefore protect the class interests. Secondly, it enables the members who hold shares in one class to transfer shares to another class without upsetting the balance of interests in the company¹⁵⁵. Thirdly, it makes attendance at the general meeting easier because of the simple quorum which requires at least a representative from each class. Fourth, it may be one way of enabling those who contribute in kind such as employees and managers, to have adequate representation in the membership of the company, without the requirement of an acquisition of adequate shares¹⁵⁶. Fifth, in cases of privatisation of public enterprises, especially in developing countries, it may help to contain government contributions in the joint venture by giving it rights and obligations which aim at maintaining equal control in the company. This is done through issuing to the government what is called a golden or master share¹⁵⁷.

However, the above method can only be maintained up to a certain stage or degree of share-ownership. This is because through free transfer of shares between different members of classes, a point may be reached when the interests of the transferor and those of the transferee are no longer interdependent. Most likely the transferor will be dependent on the transferee. In other words, the transferee will be slowly 'buying out' the transferor. Thus, the classification of interests may be detrimental to the 'new majority shareholder'. It may be desirable at this stage to transform the joint venture company into a normal subsidiary company of the transferee or to arrange for a take-over in situations where the transferor totally depends on the transferee.

¹⁵³See our discussion *supra* p. 108.

¹⁵⁴See Stedman and Jones *supra* n. 147, at p. 170.

¹⁵⁵*Ibid.* pp. 170 - 171.

¹⁵⁶By offering them a small number of shares they are able to participate in a class decision making. However, it would have been better if their non-cash contributions are recognised as a class in its own right rather than offering them nominal shares.

¹⁵⁷ See chapter two *supra* p.25.

Moreover, the grouping of interests may not eliminate the deadlock element completely. This is because if classes have equal votes a deadlock situation is still possible. Parties who are likely to have this kind of deadlock may adopt methods which aim at a total elimination of deadlocks.

(c) Non-Deadlock Methods.

The possibility of the premature break up of the venture because agreement is not reached is a major disadvantage of the deadlock joint venture company. In its strict sense, the deadlock joint venture company is an inflexible creature: no resolution may be passed at the general meeting or the board meeting without unanimity¹⁵⁸. Therefore, as far as this type of a joint venture is concerned, there may be no majority or minority. Each member of the company is the minority, in the sense that, no member or class of members can reach a decision about the affairs of the joint venture company on its own or without the support of others.

Joint venturers who are aware of the dangers of a deadlocked company may try to avoid the deadlock while trying to maintain a spirit of co-operation. Therefore, in most cases joint venturers take the view that while unanimity is desirable in respect of certain fundamental matters, a more flexible approach should be taken in operational decision making to keep the venture going. There are several ways of achieving this.

One is to limit matters which require unanimous decisions to the minimum and leave other matters, especially those which concern the business operation of the venture, to the management or employees of the company. It should be emphasised at this juncture that since it is impossible for a deadlock joint venture company to pass an ordinary or special resolution, it may be proper to allocate the decisions which in other companies are passed through these resolutions to either the board or management, depending on the ability of each organ to pass them without causing problems of deadlock. Experience has shown that decisions on technical matters are better reached by technicians themselves than managers or capital contributors (shareholders). This again will depend on the allocation of rights and obligations among different organs of the joint venture company.

The second way of avoiding the creation of a deadlock joint venture company is to include in the membership a person who has been referred to as 'a swing man shareholder' or director¹⁵⁹ or 'an outside owner'¹⁶⁰. This is a shareholder, or director whose interests in the joint venture company

¹⁵⁸Brodley Joseph, *supra* n. 147, at p. 1529; Stedman and Jones *supra* n. 147, pp. 190 - 191.

¹⁵⁹See Note 'Joint Venture Corporations: Drafting the Corporate Papers', 78 Harv.L.Rev. (1964 -65), 393, a pp. 405, 408.

¹⁶⁰Brodley *supra* n. 147, at p. 1544, he refers to this person as "Outside Ownership Interest"; An outside owner

are 'independent' of any influence by members' individual interests. Usually this shareholder has greater voting rights only in cases of 'serious' deadlock or disagreement. He makes it possible for a decision to be reached in the interests of the company¹⁶¹. It is argued that this method can discourage the use of the joint venture company as a mere vehicle or instrument of one parent or more parents to further their competing (individual) interests within the joint venture, the process which may result in deadlock or collusion¹⁶². However, a swing person's collusion or agreement with one of the parents may be equally detrimental to the other party. With no guidelines as to the mutual interests of partners in the joint venture, the swing man shareholder or director device create more problems than solutions¹⁶³.

The third alternative is to give one of the parties the ability to cast a decisive vote and rotate periodically this right to all the members. Alternatively, the same can be achieved by giving the chairman of the general meeting or the board a casting vote and rotate the chairmanship to all the members, each after a prescribed period of time. However, according to Stedman and Jones¹⁶⁴ this overrides the concept of common control and is seldom commercially acceptable since in circumstances where competing interests of the parents have occupied the joint venture, it may give rise to 'tit for tat' exchanges.

The fourth method is to submit any disagreements which cause the deadlock situation to conciliation or arbitration¹⁶⁵. It is common in most joint venture companies to find that in anticipation of disputes which may arise in the future, the joint venture company's constitution is supplemented with arbitration agreements. In these agreements all members agree to submit their disputes to the arbitrator or an expert. These agreements are analysed further in the next chapter. It is enough to point out here that arbitration may not help to solve the deadlock problem. This is particularly true when competing interests of the parents are at issue. In such a situation it may be difficult to reach a compromise agreeable to all parties. An arbitrator being an outsider may not be in a position to distinguish between the interests of the joint venture and the individual competing

may be an expert or impartial person. For example in the case of *Lewis V Haas*, (1970) S.L.T (Notes) 67, two main shareholders in a company held 49% of the shares each, and the remaining 2% of the shares were allotted to the solicitor who was to act impartially in case of a deadlock.

¹⁶¹Ibid., at pp. 1544 - 1545; See also Note supra n.159; Stedman and Jones supra n. 147, at p. 193.

¹⁶²Brodley ibid. p. 1545.

¹⁶³For example, in *Lewis V Haas* supra, n. 160, the swing man shareholder could not prevent a deadlock which resulted in the application for winding up: See also *Symington V Symington's Quarries Ltd.* (1905) 8 F. 121; See also Herzfeld E. *Joint Ventures*, (1983), Bristol: Jordan and Sons Ltd., pp. 46 - 47.

¹⁶⁴Supra n. 147, at p. 193.

¹⁶⁵See for example, *In Re Yenidje Tobacco Co. Ltd.* [1916] 2 Ch. 426. In the case a quasi-partnership company, in order to avoid a deadlock situation, provided that any disagreement was to be taken to an arbitrator. However, according to the case arbitration cannot bar the court from entertaining the dispute on constitutional matters which concern company law.

interests of the parents, since these interests are inextricably linked. It may thus be difficult to reach a decision which is not detrimental to at least one of the parties¹⁶⁶. Thus, what is needed, as far as the resolution of disputes in the joint venture company is concerned, is mediation or conciliation, as opposed to adversarial arbitration. While in the latter kind of arbitration parties may be using arbitral proceedings because they want to minimise the time and money used in litigation, in the former, parties aim at restoring or maintaining co-operation¹⁶⁷.

The fifth remedy may be to resort to court. By using the relational approach, the exception to the rule in *Foss V Harbottle* could perhaps be extended to allow any member to take court action in cases where the decision of the company is being blocked by some members because of their individual interests rather than the interests of the joint venture company. This is known in company law as the protection of minority shareholders. In order to see how this principle can apply in the protection of interests in the joint venture company, we shall discuss it further below.

The Protection of "Minority" Shareholders in the Joint Venture Company at Common Law and Statutes.

Although the classical view that the share is individual property and that its holder may exercise voting rights attached to it as he wishes still exists¹⁶⁸, the view that in some instances the rights conferred to individuals, whether as majority or minority have to be exercised *bona fide* in the interests of the company as a whole, is gaining much support¹⁶⁹. Further, section 459 of the

¹⁶⁶This is because an arbitration compromise has to be accepted by all parties for it to be executed, see Note 78 *Harv.L.Rev.* supra n. 159, at p. 412. More discussion on this is provided in the next chapter infra pp 194 - 196..

¹⁶⁷For the discussion on the difference between conciliation/mediation and arbitration see Redfern Alan 'International Commercial Arbitration', *J.B.L.* [1986] 15, pp. 15 - 17; Schmitthoff Clive, 'Extrajudicial Dispute Settlement', *Forum Internationale*, No. 6 (May 1985) p. 3.; See also Christie R. H., 'Arbitration: Party Autonomy or Curial Intervention: The Historical Background' *111 South African Law Journal*, (1994), 143, at p. 144.

¹⁶⁸See for example, *Pender V Lushington*, (1977) 6 Ch. D 70, at pp. 76 - 77, per Jessel M. R; *Burland V Earle*, [1902] A.C. 83 per Lord Davey; *North-West Transportation Co Ltd. V Beaty* [1887] 12 App. Cas. 589 per Sir Richard Bagalley; *North Counties Securities Ltd. V Jackson and Steeple Ltd.* [1974] 1 W.L.R 1133; *Phillips V Manufacturers Securities Ltd.* (1917), 116 L.T 290 at p. 296 per Lord Cozens Hardey;

¹⁶⁹See for example, *Prudential Assurance Co. Ltd. V Newman Industries Ltd.* [1981] Ch. 257 at 327 per Venillot J.; *Clemens V Clemens Bros. Ltd. and other* [1976] 2 ALL ER 268 per Foster J; *Allen V Gold Reefs of West Africa Ltd.* [1900] 1 Ch. 656, per Lindley M.R; *Mayer V Scottish Textile and Manufacturing Co. Ltd.* *Scottish Co-operative Whole Sale Society Ltd.* (1954) S.C 381, per Lord Cooper at p. 392; *Ebrahim V Westbourne Galleries Ltd.* [1972] 2 ALL ER 492, at 500 per Lord Wilberforce; *Estmaco (Kilner House) Ltd. V Grater London Council* [1982] 1 W.L.R 2, per Sir Robert Magarry V. C; *Daniels V Daniels* [1978] Ch. 406, per Templeman J; *Re Hellenic and General Trust Ltd.* [1975] 3 ALL ER 382; *Thomas V H.W Thomas Ltd.* (1984) NZLR, 99, 148, at 99, 156 per Richardson J; Riley infra n. 170 at p. 787 says: "Shareholders are prepared to agree at the out to leave so many matters to the determination of the majority... only because there exists a foundation of trust between them, and reasonable expectations of good faith in the operation of the majority rule".

English Companies Act has been interpreted to reflect more or less the same effect¹⁷⁰. To this effect one commentator¹⁷¹ concludes:

'We are witnessing the development of a duty on the part of the [shareholders] general meeting as an organ of the company to act bona fide for the benefit of the company as a whole'.

The development of the duty on shareholders to act bona fide in the interests of the company as a whole may help in the development of a general duty which in turn may contribute to the protection of different interests in the joint venture company. However, a full recognition of this duty in company law may not develop in the near future¹⁷². Moreover, due to the unharmonised nature of the company law of different jurisdictions, its applicability to cross-national joint venture companies may face yet another hurdle of extra-territoriality¹⁷³. For these reasons the extension of a fiduciary duty to corporate shareholders in dominant-dependant relationships in the framework of the law of groups of companies has also been slow, especially in English Company Law¹⁷⁴.

In the absence of a general duty, the court uses the partnership analogy¹⁷⁵ to protect various interests in enterprises where interdependence necessitates the active participation of all members, (whether minority or majority, managers or employees). But this is limited to companies with characteristics more or less like those of partnerships¹⁷⁶. It has also been argued that section 459

¹⁷⁰The section reads: "A member of a company may apply to the court by petition for an order under this Part on the ground that the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of some part of the members (including himself) or that any actual or proposed act or omission of the company (including act or omission on its behalf) is or would be prejudicial"; On its analysis see for example, Farrar H.J. supra n. 108 pp. 396 - 401; Xuereb Peter 'The Limitation on the Exercise of Majority Power', 6 Co. Law, (1985), 199; Xuereb Peter 'Voting Rights: A Comparative Review', 8 Co. Law (1987) 16; Xuereb Peter 'Remedies for Abuse of Majority Power' 7 Co. Law (1986), 53; Ralph Instone, 'Unfair Prejudice: An Interim Report', J.B.L. [1988], 20; Prentice D.D. 'The Theory of the Firm, Minority Shareholders Oppression: Sections 459 - 461 of Companies Act, 1985', 8 Oxf. J. Leg. St. (1988), 55; See also Riley Christopher, A. 'Contracting Out of Company Law: Section 459 of the Companies Act, 1985 and the Role of the Courts', 55 M.L.R. (1992) 782.

¹⁷¹Xuereb Peter, 'Remedies for Abuse of Majority Power' *ibid.* at p. 53; This position is supported by Farrar *ibid.* at p. 401.

¹⁷²See our discussion *infra* pp 132.

¹⁷³See our discussion in the next chapter.

¹⁷⁴See for example, Tunc Andrew, 'Duties of a Dominant Shareholder', in Schmitthoff M. Clive and Wooldridge Frank, (Eds.), Groups of Companies, (1991), London: Sweet & Maxwell, at pp. 1 - 19; Prentice D.D, 'Groups of Companies: The English Experience', in Hopt J. Klaus (Ed.), Groups of Companies in European Laws, (1982), Berlin and New York: Walter de Gruyter, at pp. 116 - 125.

¹⁷⁵See for example, Re Yenidje Tobacco Co. Ltd. [1916] 2 Ch. 426; Ebrahimi V Westbourne Galleries Ltd. [1972] 2 ALL ER 492; [1973] AC 360; Re Davis and Collett Ltd. [1935] 1 Ch. 693; Prentice D.D "Winding-Up on the Just and Equitable Ground: The Partnership Analogy, 89 L.Q.R. (1973), 107.

¹⁷⁶Known as quasi-partnership companies or incorporated partnerships. However, it was held by Lord Shaw in Loch V John Blackwood Ltd. [1924] A.C. 783 that the fact that a company is not a private company, does not, and should not, preclude it from being treated as an incorporated partnership. This is so especially, in Lord Shaw's words, at p. 786: "[Where] it is thus seen that although taking the form of a public company the concern [is] practically a domestic and family concern".

of the Companies Act (1985) works more effectively in small or quasi-partnership companies¹⁷⁷. The justification for the use of the partnership analogy was given by Lord Wilberforce in *Ebrahimi V Westbourne Galleries* that: "it is the law of partnership which has developed the conception of probity, good faith and mutual confidence"¹⁷⁸. The analogy with partnerships is made to ensure that the interests of all members are protected in a company which has superimposed in its establishment one or more of following elements: (i) an association formed or continued on a basis of a relationship involving mutual confidence and trust, (ii) an agreement, or undertaking, that all, or some of the shareholders shall participate in the conduct of the business, and (iii) restriction upon the transfer of the member's interest in the company so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere¹⁷⁹. These elements are also common in joint venture companies¹⁸⁰. Mutual confidence and good faith between the members of such a company are crucial in maintaining interdependence and the active participation of all members.

According to section 459 of the English Companies Act any member of the company can apply to the court for an order when the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of the company, including its interests. If the court feels that the application is justified, it may grant the relief sought¹⁸¹.

In a company which has characteristics like those of a quasi-partnership, members' interests which are protected by section 459 of the Companies Act, (1985), thus justifying a court action by the aggrieved party, centre on four main areas: (i) interest in participation in the company's management, given members' close involvement in the company; (ii) interest in the status quo, given the equal importance of each member's contribution, regardless of the number of shares it holds; (iii) interest in the proper conduct of the company's affairs in order to ensure continued goodwill among the members; and, (iv) interest in the financial position of the company, given the commitment of their personal resources and skills to the company.¹⁸²

¹⁷⁷See for example, Hannigan Brenda, "Section 459 of the Companies Act 1985 - A Code of Conduct for the Quasi-partnership?", *L.M.C.L.Q.* [1988] 60, at p. 61; Riley Christopher, A. "Contracting Out of Company Law: Section 459 of the Companies Act, 1985 and the Role of the Courts", *55 M.L.R.* (1992) 782; Rider, "Partnership Law and its Impact on Domestic Companies" *C.L.J.* [1979], 148.

¹⁷⁸*Supra* n. 157 at p. 379.

¹⁷⁹*Ibid.* at p. 379.

¹⁸⁰See our discussion in chapter two *supra* pp 28 - 31. See also Elizabeth Jane Boros, *Minority Shareholders: Prevention and Remedy of Common Grievances*, (1992), Ph.D Thesis, Cambridge University, pp. 41 - 46.

¹⁸¹For example, the court may require the company not to make any, or any specified, alteration in the constitution of the company, or it may make orders regulating the future conduct of the company's affairs, it may order the company to stop or refrain from the act complained of, etc. See Linklaters & Paines, *Joint Ventures*, (1990), London: Longman, pp. 47 - 48.

¹⁸²See Hannigan *supra* n. 177 at p. 63; See also *Re Bird Precision Bellows Ltd.* [1984] Ch. 419; *Clemens V Clemens Bros. Ltd.* [1976] 2 All ER 368.

Thus, members in the joint venture company, being members in one type of closely held corporation, might seek a court order to restore the status-quo, whenever other members occasion a deadlock situation in order to pursue interests other than those of the joint venture company.

Alternatively, when the deadlock in the joint venture company has worsened to the extent that section 459 cannot restore the original parties position, the aggrieved party(s) may use the provisions of section 122 of the *Insolvency Act (1986)* to apply for a compulsory winding up of the joint venture company, on just and equitable grounds.

In *Ebrahimi V Westbourne Galleries*¹⁸³, the plaintiff who was a shareholder and a director in the defendant quasi-partnership company successfully applied for the company's winding up after his co-members had decided to terminate his directorship. According to Lord Wilberforce:

"The just and equitable provision...comes to his [the plaintiff] assistance if he can point to, and prove, some special underlying obligation of his fellow member(s) in good faith, or confidence, that so long as the business continues he shall be entitled to management participation, an obligation so basic that, if broken, the conclusion must be that, the association must be dissolved".¹⁸⁴

One shortcoming of the court solution is that, it may not help members of the joint venture company who join because of their managerial skills or technical know-how, unless they acquire some shares in the company. This is because in order to protect their interests as employees, they have first to prove that they are shareholders¹⁸⁵. Problems of not recognising the management and other employees as members of the company in their own right are analysed shortly. Suffice it to say here that the court solution, however just it may look, may be of a short term effect. At worst it may exacerbate non-cooperative behaviour in the joint venture company which is already deadlocked. Indeed, the application for winding up on just and equitable grounds is nothing but a remedy of a last resort. As argued elsewhere, the failure to reach a co-operative decision, may be an indication that the level of interdependence which was the basis of establishing the joint venture company is slowly moving to a dominant-dependant relationship. Thus, it may be in the mutual interests of the members, in order to avoid steps which have the effect of accelerating the termination of the joint venture company, to include in the constitution of the joint venture company or in the shareholders' agreement a procedure for terminating the joint venture company without dissolving it or going to court¹⁸⁶.

¹⁸³Supra n. 175.

¹⁸⁴Ibid. at p. 380.

¹⁸⁵See *Re A Company*, [1983] 2 ALL ER 854; See also Hannigan supra n. 177 pp. 60 - 62.

¹⁸⁶The termination of the joint venture company is discussed infra pp. 161 - 165

4:4:3. SHAREHOLDERS-MANAGEMENT, AND EMPLOYEES RELATIONS IN THE JOINT VENTURE COMPANY.

The legitimization of the management position in the corporate structure has been a matter of controversy both in theory and practice¹⁸⁷. The Legal entity approach, whose doctrinal arguments are based on the assumption that 'in the beginning there was a company'¹⁸⁸, assumed *a priori* that the interests of the company meant the interests of shareholders. Other actors within the company such as the managers and employees had to put the interests of shareholders first in all activities of the company. The directors' fiduciary duties were owed to the shareholders through the company¹⁸⁹. The contractual paradigm also uses market forces to ensure that shareholders control the acts of managers. On the contrary, the relational approach contends that the company represents the interests of all actors - shareholders, managers and employees being the main actors¹⁹⁰. Having shown in the previous part how company law protects the interests of shareholders in the joint venture company, below I show how it protects the interests of other actors.

According to Article 70 of Table A of the English Companies Act¹⁹¹:

'Subject to the provisions of the Act, the memorandum and articles and any directions given by special resolution, the business of the company shall be managed by the directors who may exercise all the powers of the company...'

The interpretation of this article has been a matter of contention as to whether shareholders in the general meeting can interfere the decision of the board as regards those powers given to the board by the constitution of the company¹⁹². However, it is increasingly accepted that in modern corporations the era of regarding shareholders' general meeting as the supreme organ or the only constituency of the company is gone. The modern version of shareholders-management

¹⁸⁷See for example, Goldberg, G.D, 'Article 80 of Table A of Companies Act, 1948', 33 M.L.R., (1970), 177; Sullivan G.R, 'The Relationship between the Board of Directors and the General Meeting in Limited Liability Companies', 93 L.Q.R., (1977), 569; Gower *supra* n. 6 Chs. 19 & 22; Pennington *supra* n. 25, pp. 572 - 583. Some company law theorists argue that classical theoretical models aim at offering an explanation for the legal power which company law vests in the management', see for example, Stokes Mary 'Company Law and Legal Theory', in Twining, W. (Ed.) Legal Theory and Common Law, (1989), New York: Blackwell Inc, at p. 155.

¹⁸⁸See our discussion in chapter three *supra* pp 54 - 60.

¹⁸⁹Hutton V Cork Rly Co. (1883) 23 Ch.D 654; See our further discussion *infra* pp. 127 - 132.

¹⁹⁰See our discussion in chapter three *supra* pp. 66 - 84.

¹⁹¹English Companies Act, 1948, First Schedule; See also the corresponding article 80 of Table A in the First Schedule of the Tanzanian Companies Ordinance.

¹⁹²See the articles by Goldberg and Sullivan *supra* n. 187.

relationship was firstly expressed by Greer L.J in Shaw & Sons Ltd. V Shaw¹⁹³ that:

'A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors, certain other powers may be reserved for shareholders in the general meeting. If powers of management are vested in the directors, they and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles in the directors is by altering their articles, or, if opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove'.

The justification which may be offered for this separation of powers and duties between shareholders and management is that, as opposed to ancient companies where shareholders could control the management or even manage for themselves the affairs of the company, modern companies involve more complex business relationships which need special skills for their management. As Lord Clauson rightly put it: 'the professional view as to the control of the company in general meeting over actions of directors has, over a period of years, undoubtedly varied'¹⁹⁴.

In analysing whether directors are employed because of their skills, it is important to distinguish between executive directors and non-executive directors. The latter are directors who are expected to do very little or nothing other than to attend board meetings, with the aim of protecting the interests of those who appointed them. Executive directors are those who, in addition to their roles as directors, hold some executive or managerial position to which they may be appointed by the board or shareholders¹⁹⁵. They are therefore appointed by virtue of their profession or skills. The distinction between the two groups of directors is becoming increasingly important in the management of complex corporations such as joint ventures. The structure and function of the management in English Company Law may reflect this distinction if the

¹⁹³[1935] 2 K.B, 113 (C.A), at p. 134.

¹⁹⁴In Scott V Scott [1948] 1 ALL ER 582, at p. 585. Of course this does not mean that the General Meeting cannot exercise the Board's power where for one reason or another, the Board is unable to act, see for example, Barron V Potter [1914] 1 Ch. 895; Alexander Ward & Co. V Samyang Navigation Co. [1975] 1 W.L.R 673; Foster V Foster, [1916] 1 Ch. 532; Irvine V Union Bank of Australia, (1877) 2 App. Cas. 366 (P.C). But managerial skills are increasingly becoming a special property and cannot be possessed by any shareholder; Professor Partkinson J.E, in Corporate Power and Responsibility, (1993), Oxford: Clarendon Press, at p. 51 quotes EC report, that: 'efficiency demands that the contributors of capital hand over management of the company's affairs to a smaller group capable of relatively quick and continuous decision making. This also permits the company's affairs to be placed in the hands of those who are equipped with special abilities and skills which are necessary for effective management which many shareholders may not themselves possess (from EC Bull Supp. 8/75, at p. 16); Easternbrook H. and Fischel D.R, 'Corporate Control Transactions', 91 Yale L.J. (1982), 698, at p. 700, say: 'Delegation of authority enables skilled managers to run enterprises even though they lack personal wealth, and it enables wealthy people to invest even though they lack managerial skills'.

¹⁹⁵ Marshall, D. Evans, 'Quantum Meruit and the Managing Director' 28 M.L.R., (1965) 347; Wedderburn, K.W, 'Contractual Rights under Articles of Association - An Overlooked Principle Illustrated', 29 M.L.R. (1966) 608; Generally see Gower supra n. 6 pp. 158 - 159.

recommendations by the *Adrian Cadbury Committee Report*¹⁹⁶ are adopted. The recommendations have the effect of separating the functions of the non-executive members of the board from those of executive members. They also aim at making non-executive members independent of the management. For example, it is *inter alia* recommended that non-executive members of the board should constitute the majority of the board, and that the chairman of the board, where possible, should be selected from non-executive members. Further, that their appointments and terms of reference should be made by the whole board and should be based on a formal selection process¹⁹⁷.

Thus, in determining the legal position of the management of modern corporations such as joint venture companies, the concept of corporate management should be analysed closely, for several reasons. Firstly, the problems of nominal versus real managerial power become apparent when the traditional notions of corporate management are applied to the management of joint venture corporations. The role of directors whose rights and duties are enshrined in separate management services agreements cannot be regarded as similar to the role of directors whose main constitutional duty is to attend the board meeting to represent the interests of shareholders. Secondly, and more important to this study, it may be difficult to identify directors who manage the business of the company and distinguish them from those who supervise its management. In other words, management and supervision must be separated¹⁹⁸. Managers who join the board of directors because they want to generate profits from their managerial skills, should be differentiated from those who join the board by virtue of being appointed by shareholders to protect the shareholders' interests. The former possess managerial skills as their personal property which they invest in the company for purposes of generating profit, just as capital might be invested. Before we dwell on the analysis of this duality in the directorship of the modern company it is important to make a brief analysis of the current legal position of employees in the management of the company.

The concept of employees' participation in the process of decision making of the company is a

¹⁹⁶See *The Financial Aspects of Corporate Governance*, London: Burgess Science Press.

¹⁹⁷*Ibid.* para 4.10 - 4.17. The Report may be criticised for not considering the aspect of workers representation in the decision making of the company. For this criticism see Wedderburn *supra* n. 102 at p. 231, footnote 59. In particular, the report has been criticised that it does not propose a two tier board system like that one proposed by the EEC 5th Company Law Directive, as discussed shortly. According to Sir Green Owen, 'Why Cadbury Leaves A Bitter Taste', in *Financial Times*, June 9th, 1992: 'If the members of the Cadbury Committee believe in a unitary board [a bifurcated board which they propose] is nonsense. If they seek this kind of segregation, they should have the courage of their convictions and advocate a two-tier structure'; See also Lex Columnun, *Financial Times*, May 28, 1992; See also Finch Vanessa, 'Board Performance and Cadbury on Corporate Governance', *J.B.L.*, [1992], 581.

¹⁹⁸Smitis S., 'Workers Participation in the Enterprise: Transcending Company Law?' *38 M.L.R.*, (1975), 1, at p. 10.

recent phenomenon in the English Company Law jurisprudence¹⁹⁹. During the capitalist era, the company was regarded as the instrument of capitalism and therefore only the interests of those who contributed capital could be identified with the company. However, today English Corporate jurisprudence widely accepts "that the company as an economic unit consists of a combination of three interest groups; the management as the directing brain of the enterprise, the shareholders as the providers of capital of the enterprise, and the employees as the providers of labour"²⁰⁰.

The recognition of employees as a part of the corporate structure has now been incorporated in the English Company Law. According to Section 309 of the English Companies Act:

'The matters to which directors are to have regard in the performance of their functions shall include the interests of the company's employees in general as well as the interests of its members'.

The idea of regarding employees as part of the corporate organisation is highly developed in some countries of continental Europe, Germany in particular²⁰¹. It is also well developed in Japan. According to the Japanese experience²⁰², employees form an integral part of the firm *for* which they work to a far greater extent than is the case for most shareholders. The Japanese model emphasises skill formation by the employees on the job in order to make an employee part of the firm and to enable him or her to engage in activities which enhance his or her long-term employment opportunities. This helps the Japanese firm to achieve internal efficiency and claim the ownership of the skills developed by different employees as the property of the firm which can be marketed.

The representation of employees in the decision making of the company should be considered on co-operation, rather than on competition between labour and capital. As argued elsewhere, co-operation entails interdependence. The fact that the owners of capital (shareholders) are unable to organise their capital and supply the required labour, and that markets for the required managerial skills and some highly skilled labour are costly²⁰³, should be seen as an important feature of the

¹⁹⁹Report of the Committee on Industrial Democracy, (1977) Cmnd. 6076, referred to as the Bullock Committee Report; See also the English White Paper on Industrial Democracy (1978), Cmnd. 7231: Generally see Gower *supra* n. 6 pp. 62 - 63 on the EEC Directive and the principle of co-determination; However, the English Company Law is reluctant to accept the employees participation in the decision making of the company, see Wedderburn *supra* n. 102, at p. 235 and footnote 79 he refers to section 309 of the English Companies Act, 1985, discussed below, as "window dressing". Its discriminatory treatment between "employees in general" and "members" (in particular?) reveals this reservation and renders the interpretation of the section ambiguous.

²⁰⁰Schmitthoff, C.M 'Employees Participation and the Theory of the Enterprise', J.B.L [1975] 265, at 266; See also Farrar J. H, *supra* n. 108, pp. 383 - 384.

²⁰¹Schmitthoff *ibid*, at p. 266; Smitis *supra* n. 198.

²⁰²Aoki Masahiko 'Aspects of the Japanese Firm', in Aoki Masahiko (Ed.) The Economic Analysis of the Japanese Firm, (1984), Amsterdam: North-Holland, at pp. 4 - 38, esp. p. 5.

²⁰³See footnote 144 *supra*.

joint venture company. It is because the interests of employees and directors are interdependent with those of shareholders that they require the means to participate in the decision making of the company in matters concerning their interests. One way of achieving this is by offering them shares, in a structure where decisions about their interests are made in the general meeting of the company²⁰⁴. Another is to allow them to participate in the board of directors of the company. It is in the latter sense that the duality of the board of directors manifests itself. On one hand the board represents the interests of the actors in the company, namely shareholders, managers and employees. Yet on the other it is the organ which is entrusted with the management of the business of the company. This is why the managerial role of the board should be distinguished from the supervisory role.

The duality in the management of the company may be incorporated in the English Company Law after the 5th EC Directive has come into force, and if adopted²⁰⁵. The 5th EC Company Law Directive proposes two alternative ways of ensuring the representation of management and employee's interests in the companies' decisions. One alternative is by establishing what is known as a *Two Tier Board System*. This system divides the board into two tiers, the supervisory board and the management board. The supervisory board represents the interests of shareholders, management and employees. It is therefore the supreme body of the company. The management board becomes an organ of the providers of managerial skills, being assigned with duties of managing the business of the company. Another alternative retains the traditional *Single Tier System* but ensures that the interests of shareholders, managers and employees are represented in the board or in workers councils as the case may be.

The latter model may be accepted by countries like Britain whose company laws have a single board system while the two tier model may be accepted by countries like Germany who have that model in their company laws. The issue whether either of the models may be appropriate to the joint venture companies in developing countries will be discussed after the determination of how company laws of Tanzania and Britain operate the single tier model.

COMMON LAW POSITION ON DIRECTORS DUTIES.

The common law position as regards the duties of directors has changed considerably since the

²⁰⁴See supra p 112.

²⁰⁵The latest version of this Directive appears in EEC, Harmonisation of Company Law in the European Community: Measures Adopted and Proposed, Situation as at March 1992, (1993), Brussels: EEC, pp. 203 - 241. OJ. No. C 240 of 9. 9. 1983, pp. 2 - 38. Although there are more than two suggestions, especially as far as the participation of workers is concerned, for the purpose of our analysis we shall use only two alternatives.

case of Shaw & Sons Ltd. V Shaw.²⁰⁶

In imposing fiduciary duties on the directors, courts have generally used both the law of trust and the law of agency. Hence, it may be appropriate for our analysis to group Common Law duties of directors under; (i) fiduciary duties of loyalty and good faith and, (ii) duties of care and skill. However, there are general considerations relevant to both types of duty which we shall discuss first.

First, directors owe fiduciary duties to the company as a whole not to individual members or persons who have not yet become members²⁰⁷. However, this does not mean that members cannot reach separate agreements with directors to establish different duties with them which they will have to fulfil under contractual obligations²⁰⁸.

Secondly, these duties are not restricted to directors of the company alone, they apply to those who are authorised to act on the company's behalf in the managerial capacity²⁰⁹. We shall argue in this study that for this reason these duties should apply to even shareholders and employees who act in the managerial capacity in relation to the company or who influence a decisions of those who act in a managerial capacity.

(i) Duty to act in good faith.

This duty is subjective in the sense that directors have to act in what they consider - not what the court or law considers - is the interests of the company²¹⁰. Thus, in fulfilling their duties, directors have to act not according to the classical approaches which favour the interests of shareholders alone. This is because as Latham C. J.²¹¹ said, 'directors are not required by law to live in an unreal region of detached altruism and to act in a vague mood of abstraction from obvious facts

²⁰⁶[1935] 2 K.B 112 (C.A); See also Parkinson supra n. 194. pp. 73 - 96.

²⁰⁷This was firmly established in Percival V Wright, [1902] 2 Ch. 421; See also Bell V Lever Bros. [1932] A.C, 161, (H.L); Re Horsley & Weight Ltd. [1982] Ch. 442, (C.A); Winkworth V Edward Baron Department Co. Ltd. [1986] 1 W.L.R, 1512, (H.L); According to Parkinson supra, n. 194 at pp. 79 - 87 the company as a whole means the interests of all the constituencies of the company, including the interests of present and future shareholders, management, employees and creditors; See also Schmitthoff supra n. 200 at p. 265; Gower L.C.B, 'Corporate Control: the Battle of the Berkeley' 68 Hav.L.Rev. (1955) 1176.

²⁰⁸Briess V Woolley [1954] A.C 33 (H.L); Coleman V Myers [1977] 2 N.Z.L.R 225; Gower supra n. 6 at p. 552. These agreements specifically involve executive directors and are used in joint venture companies, see infra ch six pp. 238 - 240.

²⁰⁹Canadian Aero Service V O'Maley (1973) D.L.R, 371, at p. 381; The English Companies Act has introduced the concept of shadow directors to this effect, see infra pp. 131 - 132.

²¹⁰Per Lord Green in Re Smith V Fawcett [1942] Ch. 304, at p. 306; See the meaning of a company as a whole supra n. 207.

²¹¹In the Australian Case of Mills V Mills (1938), 60 C.L.R 150, at p. 164.

which may be present to the mind of any honest and intelligent man'. They have to act in the interests of the company as a whole, and in this sense the company as whole should be interpreted to include the interests of all the internal actors of the company who contribute to the company's internal efficiency, including themselves. Indeed, when the company is a solvent going concern the interests of employees may be favoured on the basis of furthering the interests of shareholders.

*(ii) The Duty to act for proper purpose.
(duty of care and skill)*

Most directors are engaged by the company because of their managerial skills. Although Common Law has given them discretionary powers, that discretion is limited. Directors have to use their skills for proper purposes. That is, they have to act for purposes which are not different from those for which that power was conferred upon them. They must favour the interests of the company, not their individual interests²¹². Courts in some instances have tried to use an objective criterion to guide the directors in exercising their discretionary powers for proper purposes. For example, it has been held that directors should exercise their powers according to the limitations provided in the articles unless some other course of action is urgent and critical for the survival of the company²¹³.

Perhaps the fiduciary duties discussed are insufficient to determine what directors should do in managing the business of the company. It is difficult to draw a line between the self interest of directors and the interests of the company. In order to have a realistic test of the functioning of fiduciary duties, it must first be accepted that some self-interest of the directors are included in the interests of the company. Directors should be said to have acted in their self-interests, not in the interests of the company, when they tend to pursue interests which are beyond the overlapping interests with those of other constituencies. It is when they want to pursue the latter category of interests that it may rightly be said that they have breached their duties to the company. Thus, they are required by law to get the permission of other constituencies by way of disclosing those interests to them if they intend to pursue individual interests²¹⁴.

²¹²Punt V Symons and Co. Ltd. [1903] 21 Ch. 506; Piercy V S. Mills & Co Ltd. [1920] 1 Ch. 77.

²¹³Winthrop Investment Ltd. V Winns Ltd. [1975] N.S.W.L.R, 666, (C.A), at 832.

²¹⁴The principle of disclosure which is now a statutory duty was enunciated in Gertmell's Case (1874), L.R 9 Ch. App. 691 by Lord Ganworth L.C; See also Guinness plc. V Saunders [1990] 2 AC 663, (H.L.); Hely Hutnchinson V Brayhead, [1968] 1 Q.B 549; But see also the view of Sullivan, 'Going it Alone - Queensland V Hudson', 42 M.L.R (1979), 711 - 715; The new approach to the concept of ultra vires which requires directors to disclose to shareholders all acts which are beyond the constitution of the company may be based on this principle. See supra pp 101 - 105. on the discussion on ultra vires.

STATUTORY DUTIES OF DIRECTORS.

The English Companies Act now recognises the fact that the interests of the company cannot be equated with the interests of shareholders alone. This can be implied from section 309 of the Act. No such provision appears in the Companies Ordinance of Tanzania. Such a provision is needed for the effective regulation of the duties of directors of joint venture companies being formed in developing countries such as Tanzania.

Further, both the English Companies Act and the Tanzanian Companies Ordinance render void any provision whether contained in the company's articles or in a contract with the company or otherwise which purports to exempt directors or officers of the company from liability to which, by virtue of any rule of law they are liable²¹⁵. This provision has been interpreted to mean that although it may be just and equitable for the company to allow directors in some circumstances to pursue their individual interests when they disclose them to the company, they are still legally required, when in that pursuit their individual interests conflict with the interests of the company, to prefer the interests of the company²¹⁶. This interpretation is based on the assumption that the company cannot allow directors to perform acts which defeat its interests.

Apart from that provision Company law also requires directors to honour certain specific obligations. For example, directors are required to declare to the board their individual interests in all contracts or transactions which the company enters with third persons²¹⁷.

Sections 318 and 319 of the English Companies Act require all contracts of service between the company and directors (executive) to be kept together with the register for public inspection. Section 319 further prohibits any contract of service or for services to include a term that the contract is not terminable by the company for a term exceeding five years unless approved by the company²¹⁸. These sections are intended to reduce the tendency of some directors to enter into agreements with the company which cannot be changed to reflect the state of interdependence between the directors and other members of the company. Contracts of service may result in self-dealing acts (shirking) if not reviewed. The above provisions do not appear in the Tanzanian

²¹⁵Section 310 of the English Companies Act. However, the amended version of 1989 of the English Companies Act permit insurance by the company against the negligence of directors.

²¹⁶John Birds, 'The Permissible Scope of Articles Excluding the Duties of Company Directors' 39 M.L.R. (1976) 394; Parkinson J.E, 'The Modification of Directors Duties' J.B.L. [1981], p. 335; See also Vinelott J. in Movitex Ltd. V Bulfield [1988] B.C.L.C, 104, at pp. 120 - 121.

²¹⁷Section 317 of English Companies Act, 1985.

²¹⁸The Cadbury Committee Report recommends that this period should be reduced to three years. See para 4.41 *supra* note 196. It is argued that this would strengthen shareholders control over levels of compensation for loss of office. But above this, it may also enable parties to the joint venture company to re-adjust more quickly to their new level of interdependence.

Companies Ordinance, despite their potential for controlling management service contracts which are common in joint venture companies formed in developing countries.

Apart from the above provisions, the English Companies Act also requires directors to obtain other members' permission when their transactions with the company involve company property of substantial value²¹⁹. Directors are also prohibited from obtaining loans or quasi-loans from the company in their own interest²²⁰. Again, these important provisions which regulate the use of the company's capital and assets by the directors are not included in the Tanzanian Companies Ordinance.

SHADOW DIRECTORS.

In recognition of the fact that acts of directors are not, in some instances, independent, English Company law has introduced the notion of a shadow director. A Shadow director is a person in accordance with whose directions or instructions the directors of the company are accustomed to act²²¹. This does not include directions given in a professional capacity and shadow directors are not liable in circumstances in which internal or *de jure* directors owe a duty to the company. The notion of shadow directorship was introduced to prevent individuals who remain backstage directing the affairs of the company from escaping certain liabilities and responsibilities imposed on *de jure* directors²²². This study will show how the provisions which apply to individual shadow directors can apply to joint venture companies.

According to Palmer's Company Law²²³ the notion of shadow directors might apply to groups of companies if the holding company or the parent company actually directs or influences the directors of the subsidiary company to act in accordance with the directions of the parent company²²⁴. In *Kuwait Asia Bank EC V National Mutual Life Nominee Ltd*²²⁵, it was held *inter*

²¹⁹In 1993 substantial property meant assets of the company the value of which exceed £100,000 or 10% of the company's assets if more than £2,000 worth the company assets, see section 320.

²²⁰Sections 330 - 344. This prohibition extends to loans made to the parent or holding company, see Gower *supra* n. 6 at pp. 583 - 584.

²²¹However, in England the concept of shadow directors does not apply to *de jure* directors, see Morse Geoffrey *Palmer's Company Law*, para 8.001.

²²²*Ibid.* para 8.003.

²²³*Ibid.*

²²⁴Hugh Collins, 'Ascription of Legal Responsibility to Groups in Complex Pattern of Economic Integration', *53 M.L.R.* (1990), 731, at p. 741 he is of the view that: '[The] concept of shadow director should often encompass parent companies for they seem to exercise precisely...control over the board of directors of subsidiaries. Although this does not go far as to render parent companies liable in general for the debts of their subsidiaries, they may become liable for wrongful trading when there has been both active engagement to the subsidiary plus gross negligence with respect to the solvency of the subsidiary'.

²²⁵[1990] 3 ALL ER 404.

alia that the Directors of the parent company are liable when the Directors of the subsidiary company²²⁶ are accustomed to act according to their instructions or the instructions of the parent company. According to Lord Lowry²²⁷ the parent company has a duty to: "refrain from exploiting its influence over its employees [directors nominated by it] and this [duty] is not different from the duty of a father not to exploit his influence over a son who is a director or the duty of a businessman not to exploit his influence over a business associate who is a director".

Although the concept of shadow directors is not yet included in the company laws of developing countries²²⁸, the relationship between directors of a joint venture company and their parent companies need to be made clear by law. This is because in most cases it is the parent companies who nominate the directors of the joint venture company. By utilising the concept of shadow directors, the fiduciary duties which apply to the directors of the joint venture company may be extended to parent companies who influence or control the decisions of the directors of the joint venture company.

Towards a general principle of fiduciary duties?

Is company law developing towards the general principle of fiduciary duties which would require all the constituencies of the company to act *bona fide* in the interests of the company? We have seen when discussing the rights and obligations of shareholders that shareholders, in making certain decisions, are required to look to their interests in relation to the interests of other shareholders. We noted further that the definition of a member of the company should include all the constituencies of the company and that directors have the duty to act in the interests of the company as whole. Against this background it may be argued that when the concept of shadow directors is considered in the light of the relationships which make up the company, one sees the possibility of shareholders having an implied, or sometimes a direct, fiduciary duty towards the company itself. If the concept of shadow directors is construed widely, it may include also employees of the company who are able to influence the decisions of the, directors, especially on technical matters where they are exclusively competent. Thus, a question arises as to whether this is a development towards the recognition of a general fiduciary duty applicable to all actors in the company, to act *bona fide* in the interests of the company²²⁹. This study does not attempt to answer that question. This duty (if developed) would help to keep the interests of the joint venture company's participants within the 'overlapping zone' (the joint venture company zone).

²²⁶In fact this was a joint venture company with 49% - 51% share-ownership.

²²⁷Supra n. 225, at p. 424.

²²⁸Specifically, the company laws of Tanzania.

²²⁹Refer also to the views by Gower supra n. 6 at p 602; Hugh Collins supra n. 224; Foster J, in Clemens V Clemens & Bros. Ltd. [1976] 2 ALL ER 268, at pp. 280 - 282; Farrar supra n. 108; Xuereb P. supra n. 171.

The discussion on the duties of the directors of a joint venture company will shed more light to assist anyone who wishes to pursue this question further²³⁰.

JOINT VENTURE COMPANY'S MANAGEMENT.

While in other companies the management (directors) of the company may be selected by the majority shareholder²³¹, in the joint venture, the very nature of interdependence, dictates that the procedure of management selection should be different. Membership of the management of the joint venture company is normally determined by giving each parent an equal right of representation in the board of directors of the joint venture company²³². Just as participants in the closely held company usually constitute its board, the parents of the joint venture company usually select their own directors to sit on the board of the joint venture company. Thus, it may be unlikely that these directors, owing primary allegiance to their parents, will ever decide contrary to the wishes, interests or sometimes directions of their parents²³³. This fact necessitates a deep analysis of how a joint venture company may be maintained as an independent economic entity within the company law provisions as discussed above. For example, do directors of a joint venture company so selected, owe fiduciary duties to the joint venture company or to one or all of its parent companies. In order to answer this question we first, but briefly, analyse the concept of interlocking directors and how it may apply to the directors of a joint venture company.

Nominee and Interlocking directorships in the joint venture company.

Sometimes the relationships between different companies may necessitate close co-operation or joint decisions on matters which are of mutual interest. Sometimes this leads to the application of interlocking directors or nominees of these companies²³⁴. This is seen by some writers as an indicator of the development in inter-corporate cohesion, interdependence and joint-control²³⁵. Generally speaking this development leads to the formation of joint organisations such as joint venture companies. The director in such a situation has to act in the interests of the company he is managing (let us say the joint venture company). As long as there are no conflicts of interest

²³⁰See for example, Xuereb *ibid.*.

²³¹Pennington *supra* n. 25 at pp. 532 - 535.

²³²See Note 78 *Harv.L.Rev.*, *supra* n.159 at p. 398.

²³³*Ibid.* p. 399.

²³⁴See Farrar *supra* n. 2 at pp. 590 - 592.

²³⁵Farrar J.H, 'Ownership and Control of Listed Public Companies: Revising or Rejecting the Concept of Control', in Pettet G. B, (Ed.) *Company Law in Change: Current Legal Problems*, (1987) London : Stevens & Sons, at pp. 55 - 57.

between the nominator company and the joint venture company, the law of fiduciary duties may apply to him without any problem. However, if he is obliged to act in the interests of the nominator to the detriment of the joint venture company, it will be unlawful. "As soon as the interests of the two companies are in conflict nominee directors are placed in an impossible position"²³⁶.

The position of the court is not yet settled. While there is a view that it may be in the interests of the company if nominee directors represent and advocate the interests of their patrons (e.g. joint venture companies)²³⁷, the court also advises that such a director does not need to approach the affairs of the joint venture company with an open mind. This view, although preferred by some company law writers²³⁸, may cause unanswered questions where such a director breaches his fiduciary duties to the joint venture company because of fulfilling his duties in his nominator or parent company.

When the phrase 'in the interests of the company as a whole' is looked at from the relational perspective, the answer may be different. It may be discovered that directors have to express their loyalty to their parent companies as long as it is in the interests of all the constituencies of the joint venture company to do so, or as long as the overlapping interests of all members (including those of the nominator company) are not in danger. Any actions of directors beyond that, though in the interests of their nominators, will be a breach of their fiduciary duties, if not *ultra-vires*, the joint venture company. By using the latter interpretation, all the fiduciary duties that apply to the directors of other companies may be applied to the directors of joint venture companies, depending on their objects, and the structure of the board of directors of the joint venture company.

*The structure of the board of directors of the
joint venture company.*

The ideal structure of the board of directors of a joint venture company will be one in which all the interests of the parent companies are represented. This is because no party will allow major decisions by the joint venture company to be taken without an assurance whether its interests are

²³⁶Ibid. at p. 55; See also Boulting V A.C.T.A.T., [1963] 2 Q.B 606, per Lord Denning; Scottish Cooperative Wholesale Society V Mayer [1959] A.C 324.

²³⁷London and Mashonaland Exploration Co. Ltd. V New Mashonaland Exploration Co. Ltd. [1891] W.N 165 per Chitty J.; Abbey Glen Property Corp. V Stumborg (1976) 65 D.L.R (3rd), 235, at p. 278; Levin V Clark [1962] N.S.W.R. 686; Re Broadcasting Station 2 GB. Pty Ltd. [1964-65] N.S.W.R, 1648.

²³⁸For example Farrar supra n. 235.

protected. But as we shall see below, this may not be possible in joint venture companies where some of the parent companies lack managerial skills. It is important therefore, to devise a management structure through which all the overlapping interests of the parties can be protected at the same time without sacrificing the objects for which the joint venture company is established.

According to Killing²³⁹ there are three structures of management which may be adopted by joint venturers, namely, (i) dominant parent management, (ii) shared management, and (iii) independent management. We shall analyse these structures and determine whether they can fit in the structures provided by company law.

(i) Dominant parent management structure.

This is the structure in which only one parent company is entrusted with the management of the venture. This structure is common (and may be adopted) in joint venture companies which are formed where one parent has superior managerial skills. The important feature of this structure is that the joint venture company is managed by one of its parent companies virtually as if it were a wholly-owned subsidiary²⁴⁰. All functional managers, for example, the general manager, production manager, financial manager, chief engineer etc., are provided by that parent company. This structure may be ideal for joint venture companies being formed in developing countries where most of the local companies lack managerial skills and technical know-how. However, it has some problems as well.

Firstly, other partners (dormant or passive parents) may feel that their interests are not well protected. It needs a high level of trust and confidence to leave all the affairs of the venture to a 'stranger'.

Secondly, and this is more important to local companies in developing countries who wish to establish joint venture companies with TNCs, such a structure may not serve some of the purposes for which joint ventures are established. This is because, if the management is provided by a foreign company alone, though this may guarantee efficient production in the venture, it may not be a good way of transferring managerial skills and know-how to the indigenous people. This proves that the joint venture method is not an end in itself. A system which enables local companies to participate in the management at least as learners is thus needed.

²³⁹Strategies for Joint Ventures Success, (1983) London: Routledge, pp 16 ff.

²⁴⁰*Ibid.* p. 16.

According to Killing²⁴¹, passive parents' interests may be protected by establishing another board of directors which includes their representatives in the hierarchy of the management of the venture. This board does not play an active role in the day to day activities of the venture, it is only given power in deciding on important matters of policy for the venture and in supervising the management.

When considered from the point of view of the management structure as provided by company law, the above proposal reflects a two tier board system²⁴². Therefore, countries such as Tanzania which lack managerial skills, and have only a single tier board system, should consider introducing the two tier board system, to take care of the management structure of joint venture companies.

(ii) Shared Management structure.

In this type of management structure, management is shared among parent companies. This is common in joint ventures that are established by parties with equal or interdependent managerial skills. For example, one parent may be an expert in organising production and another parent in marketing²⁴³. The board of directors of such a company may have real influence in the decision making of the joint venture company at all levels and in all matters. Thus, if it is not well organised it may be a source of conflict between the parents.

Because of the interdependence of the power of each party to manage the activities of the venture, each party may want to have a veto in the decisions of the venture. Thus, in such structures the constitution of the joint venture may include provisions geared to reducing some of the possibilities of deadlock at the board level²⁴⁴. However, as we saw when discussing deadlock in the general meeting, the board may be established on the basis of interdependence and co-operation as a way of avoiding disputes. Disputes may be resolved at board level by negotiation rather than by resorting to the application of the power of veto.

If we analyse this structure of management in the light of the management structures provided by company law, a single tier board system seems suitable. Therefore, one may argue that to countries such as Britain which have competent managerial skills and technical know-how, the establishment of joint venture companies will not pose a legal problem as far as the structure of the management is concerned. However, such a general conclusion may be dangerous. It may not apply to particular circumstances where companies do not have the required managerial skills or

²⁴¹Ibid., pp. 17 - 18.

²⁴²Supra p 127.

²⁴³Killing supra n. 239, at p. 21.

²⁴⁴Note, 78 Harv.L.Rev., supra n. 159, at p. 408.

technical know-how. The best way is to allow both types of board system to apply and leave venturers to choose the type which is appropriate to their company, as is the case in UK where two tier board structures may be used.

(iii) Independent management structure.

There are joint venture companies whose management has no prior connections with either of the parents. In other words, the management is not taken from parent companies. Therefore, it is likely to operate more independently. To be sure, even if the management is taken from one or all of the parents, any true joint venture company which is established by parents in order to solve the problem of interdependence, should be left to operate independently. However, this is easier in situations in which the acquisition of managerial skills is not one of the reasons for establishing a joint venture. Further, according to Killing²⁴⁵, this is only possible where the management has succeeded in generating profits for the parents. While everything is going on well inside the joint venture, no parent will be justified in interfering in the internal activities of the venture. Because of non-interference by the parents, the management will strengthen itself for further success and thereby continue to detach itself from the influence of the parents.

Joint venture companies' shadow directors.

To understand how the concept of the "shadow director" can apply to the management of the joint venture company we must bear in mind the fact that the management of joint venture company, like the management of any other company, should be independent of any influence from the parent companies in managing joint venture company's business. In this sense parent companies which influence the decisions of the joint venture company's management in their individual capacity and interest should be regarded as shadow directors²⁴⁶.

There are situations where it may not be easy to hold the parent company liable. For example, where one company is the sole provider of managerial skills to the joint venture company and the activities of the joint venture company are closely connected with its activities. In such situations the joint venture company will be managed as one of the parent company's branches. This kind of a joint venture company may not be an economically independent entity and should not be regarded as a true joint venture²⁴⁷. It is a subsidiary company which forms a part of the group of

²⁴⁵Supra n. 239, at p. 22.

²⁴⁶Thus, there is a need to include in the definition of a shadow director a provision that *de jure* directors are "instructed to act on directions or instructions from the shadow". Failure to show this prevents the use of the concept to the joint venture companies' parents.

²⁴⁷Refer to our discussion in chapter three on a joint venture company as an enterprise, supra pp 76 - 77; See

the parent company. Otherwise, in an independent joint venture company even if the management is provided by one of its parent companies, that parent company has to make sure that all the activities of the joint venture company are executed in the interests of the joint venture company, not in the parent's individual interests.

4:4:4. CONTROL OF THE JOINT VENTURE COMPANY.

The modern concept of control in company law entails a number of possible interpretations. It is an ambiguous concept which can be used in different ways. In almost all instances control is associated with power²⁴⁸. However, because there is no one locus of power in a company, and the loci of power vary in importance with the various actions of different actors, control becomes even more complex. "There is ambiguity between power to control, actual exercise of control, the probability that a command with specific content will be obeyed and looser forms of control such as domination or constraint"²⁴⁹. Therefore, when analysing how the concept of control is applicable to joint venture companies, we are indeed dealing with a monster.

Earlier approaches attempted to analyse the concept of control on the basis of an *a priori* assumption that there must be 'something' which is controlled. That something is a corporate entity. The battle was not about *how* control could give rise to the existence of the company, but rather about *who* controlled the corporate entity which existed already. There was no attempt to associate the existence of the company with the concept of control. According to this approach the company was controlled by those who 'owned' it and it could be owned only by those who owned property rights in it. In this sense property meant (share) capital. However, this position involved some contradictions.

Firstly, while the intention of the approach was to promote the interests of shareholders, it paid no

also our discussion in chapter two on the definition of a joint venture, supra pp. 31 - 35.

²⁴⁸According to Parkinson supra, n. 194, at p. 8 power 'is the ability of A to cause B to behave in a manner intended by A that B would not have done without A's intervention'. In such a situation, A has some form of control to B; According to Berle and Means, The Modern Corporation and Private Property, (1967 edn.), New York: The Macmillan Co., at p. 66 control refers to the 'actual power to select the board of directors (or its majority), [it] may also be exercised not through the selection of directors, but through direction to the management, as where the bank terminates the policy of a corporation seriously indebted to it'; According to Max Weber: 'Power (Macht) is the probability that one actor within a ...relationship will be in a position to carry out his own will despite resistance', in Weber Max, The Theory and Social Organisation, (1947), New York: Oxford University Press, at p. 152; Compare with Goldsmith and Parmelee who say that control refers to the 'power of determining the board policies guiding a corporation, not to ... actual influence on the day to day affairs of an enterprise', quoted by Maurice Zeitlin, 'Corporate Ownership and Control', 79 American Journal of Sociology, (1973 -74), 1073 at pp. 1089 -1090; Compare also with the general definition of power in negotiation, discussed in chapter 3 supra p. 71.

²⁴⁹Farrar supra n. 235, at p. 39; See also Farrar supra n. 2, Ch 34.

attention to the fact that the interests of shareholders are not homogeneous²⁵⁰. Shareholders therefore needed a mechanism by which their interests could be achieved together. The rule in *Foss V Harbottle* was an attempt to provide that mechanism. The majority shareholders were regarded as the controllers of the company. But this was the beginning of more contradictions, some of which will be examined later in this chapter. It is enough to note here that after *Foss V Harbottle* it was recognised that not all 'owners' could control the company.

Secondly, the above formulation was possible only where owners of capital were able to organise the generation of profit. The moment the capital owner's skills of organisation are outstripped by the complexity of the operation, the power to control the company decreases. It is necessary to engage those who can organise capital on the owners' behalf. When the interests of owners of capital and capital organisers conflict, questions of who owns and who controls the company emerge.

It was the findings of Berle and Means in their classic book: *The Modern Corporation and Private Property*²⁵¹ who attempted for the first time to answer the above questions. However, their analysis was incomplete. They did not, for example, disapprove the traditional belief that shareholders are the only owners of the corporation. Despite their important observation that: '*the dissolution of the atom of property destroys the very foundation on which the economic order of the past three centuries rested*'²⁵². What made their findings popular is their observation that the shareholders' control is limited. In some instances it may be found that it has been taken over by the management. But the ownership of the '*atom of property*' in the company remained unaffected. For example, in one of their conclusions they said:

'Ownership of wealth without appreciable control and control of wealth without appreciable ownership appear to be the logical outcome of corporate development....This separation of functions forces us to recognise "control" as something apart from ownership on the one hand and from management on the other'²⁵³.

This conclusion resulted in what is now considered to have been their main insight: that control of the company is not necessarily linked with ownership. However, the second limb of their conclusion that control is equally separate from management has never been appreciated²⁵⁴.

While Berle and Means' findings remain important, they may have different interpretations - just

²⁵⁰Parkinson supra n. 194, at p. 55.

²⁵¹Supra n. 248.

²⁵²Ibid. at p. 8 (my own emphasis).

²⁵³Ibid. at p. 68.

²⁵⁴See for example, Stoke Mary supra n. 187, at p. 167; Farrar (1987) supra n. 235, pp. 59 - 60; Fama and Jensen 'Separation of Ownership and Control' *26 J.L&Ecn.* (1983), 301.

like the meaning of the concept of control itself. It is misleading to base the concept of control on a pre-ordained entity, separate from managers, employees and shareholders. While the issue of who owns what in the company between shareholders, managers and employees remains important for the existence of the company, Berle and Means' findings that ownership is separate from control, would mean that control of the company could be analysed separately or independently.

The modern version of control in the contractual approach is given by the Law and Economics school²⁵⁵. Most writers of this school do not involve themselves in the controversy about who 'controls' or who 'owns' the company. This is because according to this school the company does not exist. The concept of control is not differentiated from the concept of monitoring the self-dealing behaviour of the management. To this approach therefore, control means management control²⁵⁶. Thus, control is subsumed under agency theories²⁵⁷.

The first stage of control is undertaken by shareholders themselves in the *ex-ante* negotiations by charging all costs which shareholders will incur in monitoring against payment to the managers. This assumes that managers are likely to involve themselves in self-dealing activities. Another control arises from market forces. First, there are product markets. Inefficient management will affect the survival or the competitiveness of the company. Because of fear of this possibility managers will have to work as efficiently as possible. Secondly, there is the market for capital. A well run company will be more likely to obtain investment capital on better terms than a badly run company. Thirdly, there is market for management itself. Managerial skills are recognised by this

²⁵⁵See our discussion in chapter three pp 75 - 83.; See also Henry Manne, 'Higher Criticisms of Modern Corporation', 62 Colum.L.Rev. (1962), 433; Armen A. Alchian and H. Demsetz, 'Production Information, Costs and Economic Organisations' 62 Am.Econ.Rev., 777; Fama and Jensen, 'Agency Problems and Residual Claims', 26 J.L.&Econ., (1983), 327; See also Jensen and Meckling, 'The Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure', 3 J.Fin.Econ. (1976), 305; Easternbrook Frank and Fischel Daniel., 26 J.L.&Econ. (1980), 288; See also Bradley Caroline, 'Corporate Control: Markets and Rules', 53 M.L.R. (1990), 170.²⁵⁶In support of management control Adam Smith once said: 'The Directors of such companies being managers of other peoples' money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private company frequently watch over their own... Negligence and profusion therefore, must always prevail, more or less, in the management of the affairs of such a company', from Adam Smith, The Wealth of Nations, (1776), quoted by Berle and Means supra n. 248, at p. 304.

²⁵⁷Refer to our discussion about Agency Costs in chapter three supra pp 62 - 63.; See also Parkinson supra n. 194, pp. 97 - 199.

approach as a specialised form of labour and are a marketable commodity²⁵⁸. Managers who do not use their skills to maximise shareholders profits will eventually be replaced by others, given the abundant supply of markets for managerial skills. Fourth, there is market for corporate control. If managers do not work to promote efficiency in the company, the company will be subject to the threat of take-over by more a efficient company whereby inefficient managers will be replaced²⁵⁹.

The contractual approach contributes three important elements to the concept of corporate control: First, the recognition that managers are likely to pursue their individual interests if not controlled. Secondly, that managerial skills like any other commodity are capable of being marketed, just like investment capital. Thirdly, that emphasis should be put on achieving internal efficiency as the important objective of corporate control. However, there are some reservations.

The contractual approach is built on the belief that there are always markets for management control. If these markets do not exist or if they exist but are too costly, cheaper means of control are necessary. It is accepted by some writers that fiduciary duties imposed on the management are necessary if they reduce the transaction costs of monitoring²⁶⁰. Therefore, joint venture companies which are established because parties are unable to purchase managerial skills on the market cannot escape the application of fiduciary duties.

Secondly, the approach does not appreciate the fact that managers can use their managerial expertise to control shareholders. If it is recognised that managerial skill is a specialised form of labour, and that it can be marketed, then it should be accepted that managers can (and in fact do) use their managerial skills to control shareholders. This is even clearer where the market for management control is not available or is not efficient. If the owners of capital (shareholders) can control the owners of managerial skills, equally the owners of managerial skills can control the owners of capital, depending on who needs the attributes of the other most. Thus, it is evident that any study of the concept of control entails the analysis of the relations between shareholders, employees and management to determine when control should lie with the management and when it should lie with the shareholders or employees.

After Berle and Means' findings on the concept of control numerous researchers have tried to follow in their footsteps. One study on control was done by Maurice Zeitlin in 1973²⁶¹. Zeitlin

²⁵⁸Fama and Jensen, 'Agency Problems and residual Claims', supra n 255; Farrar supra n. 235, at p. 46.

²⁵⁹Farrar ibid. at pp. 46 - 47; Parkinson supra n. 194, at pp. 113 - 132.

²⁶⁰Easternbrook Frank and Fischel Daniel, 'Corporate Control Transactions', 91 Yale L.J. (1982), 698, at p. 700ff; Bradley Caroline, supra n. 255, pp. 177 - 186.

²⁶¹Supra n. 248.

regards the separation of ownership and control as a "pseudo-fact which has inspired incorrect explanations, inferences and theories"²⁶². He argues that a detailed analysis of Berle and Means' findings reveals that many of them rest upon surmise. That the empirical question of corporate control is still open and that at the end of the day the concept of control is "essentially relative and relational: how much power, with respect to whom?"²⁶³. More modern research by Edward Herman is presented in his book: *Corporate Control, Corporate Power*²⁶⁴. Although in essence Herman broadens and elaborates Berle and Means basic structural facts, his research is important to this study because it analyses the concept of corporate control as a separate category of analysis, different from ownership. By this means he managed to put forward a theory of control based on the importance of occupying a strategic position in the company²⁶⁵.

Unlike Berle and Means who limit the meaning of the concept of control to "the power to select the board of directors"²⁶⁶, Herman construes control generally. It relates to power - the capacity to initiate, constrain, circumscribe or terminate action, either directly or by influence exercised on those with immediate decision making authority²⁶⁷. He goes on to argue that there is no one locus of power, and that the power loci vary in importance by type of action. In a company, for example, workers are concerned with decisions to move the headquarters or production facilities. Investors are interested in a decision on dividend rates or major acquisition plans. The management is interested in maintaining the life of the company, e.g., acquisition of competitors or suppliers etc. These decisions are influenced and constrained by the decisions of other internal actors, but they may also be influenced or constrained by external factors. For example, government taxes, subsidies, bankers etc.²⁶⁸. Herman groups these different forms of control into two categories, namely exclusive and inclusive control. Exclusive control is exercisable by the one who has knowledge in the matter in which the decision is to be made, while inclusive control may be the ultimate control on the former. This means that if exclusive control allows an actor to occupy a strategic position so that others cannot exercise their exclusive control unless he also exercises his, then the latter exercises both exclusive and inclusive control. For example, while an engineer in a company may have exclusive control over the operation of a certain machine, his control depends on the actor who controls the availability of money to purchase that machine and the number of products to be produced on it. Thus, the two categories of control are not mutually

²⁶²Ibid. at p. 1073.

²⁶³Ibid. at p. 1090.

²⁶⁴(1981) Cambridge: Cambridge University Press.

²⁶⁵Ibid. at p. 52. he is of the view that strategic position is likely to be taken by the management because of their daily and direct command over personnel, organisation skills, and the structural and social relationships that develop on the basis of proximate command.

²⁶⁶Supra n. 248.

²⁶⁷Herman supra n. 264, at p 1; Parkinson supra n. 194 at p. 56.

²⁶⁸Herman ibid. pp. 18 - 19.

exclusive, except that one is active and the other is latent²⁶⁹.

This analysis leads Herman to the conclusion that in a company where shareholders lack knowledge of the organisation of production, their power is latent but may still be effective as a constraint²⁷⁰. Therefore, there are two aspects of control. One deals with *how* control is maintained and the other deals with *who* controls (maintains it). The first is related to the mechanics of instruments of control. The second has two related meanings. Firstly, it answers the question "who controls what?" That is, the distribution of power between shareholders, managers, employees and sometimes creditors etc. Secondly, who maintains (co-ordinates) control²⁷¹. He then concludes that:

"The failure to separate how control is maintained, and who controls has probably led to an overrating of ownership as a mechanism of control, but it may well have an under valuation of the importance of the ownership stakes of control groups and of ownership as a constraint factor....Therefore, it is a fallacy, sometimes put forward by those anxious to establish the continued importance of ownership as a vehicle of control²⁷².

The study by Herman is important to the relational approach because it tries to analyse how different groups in the corporation control and at the same time constrain each other and how a group may occupy a strategic position to have the ultimate control of the company. Thus, control in the company is dynamic, it shifts depending on the actions of each group. This essentially proves the observation by Zeitlin that the concept of control is essentially relative and relational²⁷³.

The Concept of Control and Company Law.

Both English and Tanzanian Company Law fail to provide a general definition of control. The concept of control in Commonwealth Company Laws has long been limited to share-ownership. In inter-corporate relationships this is maintained in the definition of a holding and a subsidiary company, whereby a subsidiary company is regarded as being controlled by its holding company. It can only control it by either having majority shares in it or by having rights to appoint the majority of members of its board of directors²⁷⁴. Recently however, as we have seen elsewhere in

²⁶⁹Ibid. at pp. 52 - 53, he argues that latent power becomes active in times of crisis in a company and it is normally manifested in the threat of withdrawal of the contribution by the one who practises this power.

²⁷⁰Ibid. at p. 223.

²⁷¹Ibid. at p. 24.

²⁷²Ibid. pp. 26 - 27.

²⁷³Supra n. 261.

²⁷⁴According to section 736(1) of English Companies Act, a company is a subsidiary of another company, its holding company if that other company:- (a) Holds majority of voting rights in it, or, (b) is a member of it and has the right to appoint or remove a majority of its board of directors, or, (c) is a member of it and control alone, pursuant to an agreement with other shareholders or members, a majority of voting rights in it, or if it is

this study, through the influence of the 7th EEC Company Law Directive, the English Companies Act has extended the concept of control to include dominating influence or a control contract of one company over the other, albeit for purposes of accounting only²⁷⁵.

Another indication which shows that the concept of control is broadening is case law. Vinelott J. in *Prudential Assurance Co. V Newman Industries Ltd.*²⁷⁶ was of the view that there is a *de facto* control in the company if there is no real possibility that the issue would ever be put to the shareholders in a way which would enable them to exercise proper judgement on it. That control would exist wherever the defendants were shown to be able, by manipulating their position in the company, to ensure that no action was brought. This position, if accepted, would expand the concept of control to any person in the company who is able to control others by their position whether a manager, shareholder, parent company or an engineer²⁷⁷.

By extending the concept of control the practical application of the concept will reflect its theoretical developments. This will help to determine a person who should have fiduciary responsibility for the acts of the company and thus contribute to the development of the general principle of fiduciary duties as proposed earlier on in this chapter. In this endeavour control should involve all forms of control, both negative²⁷⁸ and positive²⁷⁹.

THE CONCEPT OF CONTROL IN THE JOINT VENTURE COMPANY.

From the foregoing discussion we can gather that control is not limited to the acquisition of share-ownership rights in the company, or a right to appoint directors²⁸⁰. Control may be acquired by contract or by dominating influence. It is against this background that the concept of control in the joint venture company should be analysed.

a subsidiary of that other company. Apart from (c) above this section is in *pari materia* with section 127 of the Tanzanian Companies Ordinance.

²⁷⁵See section 258 of the English Companies Act.

²⁷⁶[1981] Ch. 204, at p. 219.

²⁷⁷See *Russel V Wakefield Waterworks Co* (1875) L R 20 Eq. 474.

²⁷⁸Negative control means constraint. According to Herman supra, n. 264, at p. 21: 'A constraint is a form of control even if negative in exercise, as it shapes the decisions made by limiting the scope of choice. In many cases the power of veto is accompanied by the power to consult and a positive say in what has to be done. A constraint also emerges into control when it extends to the power to displace the active management'; See also Parkinson, supra n. 194, at p. 62.

²⁷⁹Positive control is associated with the expertise of members, e.g. those who are capable to decide on the appropriate means of running the company. For example, appropriate machines to be purchased, appropriate investment programmes, marketing strategies etc. It is what Herman calls exclusive control. See Herman supra n. 264 at pp. 18 -19.

²⁸⁰When one analyses the right to appoint directors as one type of control in light of directors' fiduciary duties at Common Law, it may be questionable whether directors simply pursue the interests of the company as a whole.

The concept of control is crucial to the joint venture company. Joint control in the joint venture company helps to determine whether the company is really a joint venture company or it is a subsidiary of the company which alone controls it. This is why any definition of a joint venture company centres on shared or joint control²⁸¹.

The orthodox understanding of the meaning of shared control in the joint venture company was based on shared ownership. Companies which had a 50-50 share-ownership were automatically regarded as joint venture companies without paying attention to other considerations which might affect that joint control. We have shown in this chapter the different devices through which members might maintain joint control, regardless of the number of shares they own. We have also seen that companies may join a joint venture company by contributing their managerial skills or technical know-how and ensure their control through contracts or influence over the joint venture company. We therefore argue that if it is important that there be shared control in the company for it to become a joint venture company, control should be traced not only to the share-ownership, but also to other factors (such as control contracts or acts by parties) which tend to exert dominating influence over the joint venture company. This is important in determining whether a company is still a joint venture company or has become a subsidiary of the company which controls it.

Unfortunately, so far there is not any comprehensive piece of legislation which deals with control in the joint venture company²⁸². There is a need of having provisions in company laws on joint control, which *inter alia*, should prevent the threat by some joint venture members to exercise controlling influence over others²⁸³.

PART TWO.

THE JOINT VENTURE COMPANY'S BUSINESS.

We have discussed elsewhere²⁸⁴ in this study the need for a sound business as well as a balanced

²⁸¹See our discussion on the definition of a joint venture company in chapter two supra pp. 28 - 31.

²⁸²However, this does not mean that joint venture companies have no provisions on control in other laws. For example, the EEC Regulation No 4064/89 on competition law has some regulations on joint control of the joint venture companies which are applicable to member countries, including Britain. See further Downes and Elison, *The Legal Control of Mergers in the European Communities*, (1991), London: Blackstone Press, pp. 136ff; See also Fine Frank, L. *Mergers and Joint Ventures in Europe: The Law and Policy of the EEC*, (1994) (2dn. edn.) London: Graham & Trotman,.

²⁸³As seen in chapter three supra pp. 77 - 80 the concept of Groups of Companies may assist to this endeavour.

²⁸⁴See chapter three supra pp. 76 - 77.

legal framework for internal relations, if a company is to exist as an enterprise. Since a joint venture company cannot exist unless it is an enterprise, it is important that Company Law is consistent with the existence of a sound business in the joint venture company. According to Professor Paillusseau²⁸⁵ the important things for a business include: intellectual resources, skills and work, material and non-material resources, finance, contracts such as supply and franchise contracts, etc. This part of this chapter analyses how Company Law can ensure that a sound business exists in the joint venture company.

4:5. RAISING AND MAINTENANCE OF THE JOINT VENTURE COMPANY'S CAPITAL.

4:5:1 GENERAL LEGAL ISSUES.

In general legal terms the existence of a business in a company is implied from the existence of capital at the time of incorporation. The word capital may have different meanings and interpretations²⁸⁶. For the purposes of our study capital is taken to mean all inputs in monetary terms or otherwise, necessary for starting-up and operating the company's business²⁸⁷. These inputs may be tangible (money, land, furniture or stock-in-trade) or intangible (patents, copyrights, trade secrets, managerial skills, know-how, goodwill) and anything else that is needed to keep a company as a going concern²⁸⁸. In company law capital is grouped under two categories, namely share capital and loan capital. Loan capital is the capital (in most cases available in cash) which the company gets from capital markets, on the basis that the company becomes a debtor and the provider of capital becomes a creditor of the company.

Share capital comprises of all the inputs to the company that entitle the contributor to participate in the affairs of the company as a member and to have statutory as well as contractual rights against the company or other members²⁸⁹. The popular way of making these contributions is by paying or agreeing to pay in cash or in kind the value of shares issued to the contributor. In limited liability companies the level of share capital and nominal value of shares has to be

²⁸⁵Paillusseau Jean, 'The Nature of the Company' in Drury T. Robert and Xuereb G. Peter (Eds.) European Company Laws: A Comparative Approach, (1991) Aldershot: Dartmouth, p. 19, at p.25.

²⁸⁶Gower supra n. 6 at p. 199, he gives different interpretations of the word capital, eg. capital punishment, capital letter, capital ship, capital city, capital and labour, capital and income etc.; See also Farrar supra n. 2 Ch. 6: Pennington supra n.25 Ch. 9.pp. 296 - 338.

²⁸⁷Gower Ibid. p. 199.

²⁸⁸Ibid. at p. 199.

²⁸⁹According to Pennington, supra n. 25 at p. 136, contribution by a member entitles it shares in the company. He defines shares as 'bundles of contractual and statutory rights which the shareholder has against the company'.

indicated in the memorandum of association for it to be registered²⁹⁰. That is why, whatever the form of contribution, it has been convenient and conventional to place a monetary value upon it. However, in real terms share capital has commercial value only when shares are issued to the actual or potential contributor²⁹¹. This is because if that contributor accepts them then an agreement between it and the company is formed that it will pay the company the fair value of the shares in return for the rights it enjoys as a member of the company. The mode of payment is very important in ensuring that the company gets the fair value of its shares.

TYPES OF PAYMENTS FOR SHARES.

The normal method of payment for shares is by cash. However, it is possible for the company to allot shares which are deemed paid up for a consideration other than cash²⁹². Since the latter is a typical way of paying for shares in joint venture companies, it is important to discuss it in detail below.

Allotment of Shares for Consideration other than Cash.

The term non-cash contribution is very wide and if not well defined may be abused²⁹³. It should not be imagined that every contract which fails to qualify as a contract to issue shares for cash is a contract for non-cash contribution. For example, a contract which relieves the shareholder from liability to pay part of the nominal value of its shares in cash in consideration of agreeing to acquire them, is not a valid contract to acquire shares for a consideration other than cash. This is because in reality the shareholder gives nothing for the amount which its shares are credited as paid up²⁹⁴. In other words, non-cash consideration must be shown to exist in fact. It should comprise property, tangible or intangible.

(i) Tangible non-cash contributions.

Tangible non-cash contributions include all tangible property, movable or immovable. In particular, they may include land and natural resources therein, buildings, plant and machinery,

²⁹⁰Known as authorised capital, see for example section 4(4)(a) of the Tanzanian Companies Ordinance and section 2(5)(a) of the English Companies Act; See also Gower *supra* n. 6 at p. 201.

²⁹¹A binding contract to issue shares between a company and the future shareholder also has the same effect.

²⁹²According to section 99(1) of the English Companies Act allotted shares and any premium over their nominal value may be paid up in money or money's worth (including goodwill and know-how).

²⁹³Per Lord Weston in *Ooregum Gold Mining Company of India Ltd. V George Roper*, [1892] A.C 125, (P.C) at pp. 136 - 137, per Lord Watson.

²⁹⁴*Ibid*, at p 142, according to Lord Hershell: 'there must be payment in some form, even though it is not made in cash'.

spare-parts and other tangible things or materials which may be required in the operation of the company's business. The problems of contributing non-cash property to the company as one method of share acquisition centre on valuation. Some property, like land, may pose a very great difficulty in valuation. These problems are even greater in the valuation of intangible property.

(ii) Intangible non-cash contributions.

Intangible property which may be invested in modern business organisations such as joint venture companies covers a very extensive range. It is surprising to note that company laws have not yet paid sufficient attention to this fact. It seems that there is still a general consensus that intangible property can only be transferred from one company to another by licensing agreements or assignments²⁹⁵. Perhaps when enough attention is paid to the fact that in joint venture companies, intangible property can be invested, just like tangible or cash contributions, and can form a part of the company's capital assets, a change of company laws' provisions may be necessary.

Intangible property is widely referred to as intellectual property²⁹⁶. The subject matter of intellectual property is very wide and may include anything which is developed through intellectual human efforts, ranging from artistic works, films and computer programmes to inventions, designs and marks used by traders or companies for their goods or services²⁹⁷. All these phenomena may be protected under the law of intellectual property which confer exclusive rights on their 'owners'. Therefore, like other property rights, technology and know-how represented by these intangible property rights, can only be transferred to another person if the owner agrees to part with it. There are two main issues associated with the transfer of such property rights to the company by way of share acquisition. The first is on the mode of transferring this property, and, the second is its valuation. We shall return to these issues later in this part.

4:5:2. PAYMENT FOR SHARES IN COMPANY LAW.

As argued above, shares may be paid either in cash or in kind. This is made clear by section 99(1) of the English Companies Act 1985. The Tanzanian Company Law is not clear; it does not

²⁹⁵United Nations, Joint Ventures as a Channel for Technology Transfer, (1990), New York: United Nations Publications; United Nations (UNCTAD), United Nations, Major Issues Arising from the Transfer of Technology to Developing Countries, (1975), New York, UN Press.

²⁹⁶Some intangible property may not be intellectual property. For example, rights under other types of contract than the contract for transfer of technology like *chose in action* are also intangible property.

²⁹⁷See for example David I Bainbridge, Intellectual Property, (1992), (2nd edn.); London: Pitman; Cornish W.R, Intellectual Property: Patent Rights, Copyrights, Trade Marks, and Allied Rights, (1989), (2nd. edn.) London: Sweet & Maxwell.

mention specifically the mode in which shares may be paid²⁹⁸.

(a) Common Law Position.

Generally, the Common Law accepts that the shares of a company can be allotted for consideration other than cash. However, it is important to indicate in the contract for allotment that a certain number of allotted shares is deemed paid up in return for a consideration given or promised by the shareholder²⁹⁹. In this sense, mention should be made of the contribution in kind for which shares are deemed paid. For, even if the contract shows that the consideration is paid up or is to be paid in cash, the court will look into the subject matter of the bargain. This is because, the money mentioned in the contract is a mere cipher and does not affect the substance of the subject matter of the contract, that shares shall be allotted in return for property or services³⁰⁰.

If services are provided to the company before the allotment is promised, there is no valid allotment for a non-cash contribution, as past services are not consideration at all in law³⁰¹. For the same reasons a release of the company's debt where the company is only liable to pay subject to certain contingencies is not a valid non-cash contribution³⁰². In order for shares to be regarded as being issued for non-cash contribution "there must be something to be set on the credit side of the company against the liability for the amount of shares issued"³⁰³. In other words, for non-cash contributions to be regarded as paid up, the company must gain something which, according to the agreement of the parties, is worth the nominal value of the allotted shares. This makes the concept of valuation of non-cash contribution in joint venture companies crucial.

Although the valuation of non-cash contribution is important in ascertaining the value of shares deemed paid up, the Common Law position as regards valuation of contributions in kind is not yet clear. Courts treat the valuation of non-cash contributions as a matter to be negotiated between the company and the allottee of shares. They decline to limit the parties' freedom of contract. According to Sally Jones and David Bellringer³⁰⁴, companies will not be required by the court to carry out a formal valuation of non-cash contributions because of the effect of basic principles

²⁹⁸For example, see section 40 of the Tanzanian Companies Ordinance (which applies only to public companies), it describes only the mode of payment in cash.

²⁹⁹Re Hayford Co. Ltd. (1869) 5 Ch. App. 11; Re Balgan Hall Colliery Co. (1870), 5 Ch. App. 340.

³⁰⁰Re Church and Empire Fire Insurance Co. (1877) 6 Ch. D 68; Pennington supra n. 25 at p. 147.

³⁰¹Re Eddytson Marine Insurance Co. [1893] 3 Ch. 9.

³⁰²Bury V Famatina Development Corporation [1909] 1 Ch. 754; [1910] A.C 439.

³⁰³Per Farwell L.J in Bury V Famatina ibid. at p. 761.

³⁰⁴Jones Sally A. and David R. Bellringer, Share Capital: Company Law and Taxation, (1984), London: Butterworth, at p. 29; Pennington supra n. 25 at p. 149.

about consideration in contract law. "The company and every potential member are free agents and can make whatever bargain they wish, and once made the courts will enforce that bargain and not countenance a re-negotiation of it unless there is evidence of fraud"³⁰⁵.

However, it is submitted that the requirement for valuation of non-cash contributions is important for any company - especially in the case of joint venture companies most of whose contributions are made in kind. The position which rejects compulsory valuation is baseless for the reasons discussed below.

The contribution of one shareholder should not be taken in isolation. Its contribution manages to generate profits only if it is used together with the contributions of others who may have contributed in cash or in adequate non-cash contributions. According to Pennington³⁰⁶, the court should recognise the fact that other shareholders who pay for their shares in cash have an interest in the value of non-cash consideration too. He says:

"The court's unwillingness to depart from the normal principles of contract law in order to protect shareholders who pay for their shares in cash is the more surprising when it is realised that usually it is to the company promoters that shares are allotted in consideration of kind, and it is these very people who are usually also appointed the first directors of the company, and who in that capacity fix the terms on which the shares shall be allotted"³⁰⁷.

The situation described by Pennington is particular relevant to joint venture companies. However, emphasis should not be put on the comparison between those who pay for their shares in cash and those who pay in kind. Rather, it should be put on the comparison between those who pay the adequate value of shares and those who do not.

Arguments which justify the non-interference by the court or law, based on contract law principles of consideration, are irrelevant or unfounded. Even if classical principles of consideration as we know them are applied to this issue, despite arguments for their abolition³⁰⁸, it is evident that the reasons for rejecting compulsory valuation of non-cash contributions are not supported by these principles. According to classical contract law principles, consideration need not be adequate but must be sufficient. That is, it must be according to what the promisor has asked for - "If a promisor gets what he asks for in return for his promise, he has received

³⁰⁵Jones and Bellringer *ibid.* at p. 29.

³⁰⁶*Supra* n. 25 at p.149.

³⁰⁷*Ibid.* at p. 149.

³⁰⁸See for example, Corbin Arthur L., 'Does a Pre-existing Duty Defeat Consideration?- Recent Note-worthy Decision', 27 *Yale L.J.* (1917 - 18), 362, at 376; Hamson C.J, 'The Reform of Consideration' 54 *L.Q.R.* (1938) 233, 342; Atiyah P.S, *Consideration in Contracts*, (1971), An Inaugural Lecture delivered at the Australian National University, Canberra, on 29th July, 1970; Smith J.C, 'The Law of Contracts - Alive or Dead?', 13 *The Law Teacher*, (1979), 73 at 77; See also our discussion in chapter three *supra* pp. 69 - 71.

sufficient consideration and he is bound"³⁰⁹. The adequacy of the subject matter of the bargain, is none of the court's business. Thus, whether consideration is under-valued or over-valued, it is the concern of the parties³¹⁰. However, the special nature of consideration in the company law context must be understood. According to the principles of contract law, consideration is that which the promisor has asked for, which in turn will make it liable to the promisee if paid. Thus, in company law, consideration may be the nominal value of shares which the company asks potential shareholders (promisees) to pay in return for the shareholders' rights which they start to enjoy after the allotment of the shares. Company Law requires that the nominal value of each share be determined *ex-ante* in the memorandum of association. In fact this is the issue which the courts have tried to wrestle against. This is because (to echo Gower's words) the 'strait jacket' requirement for the nominal value of the share capital and shares to appear in the memorandum, does not bear any relationship with its true value even at the time of its issue, nor does it provide a yardstick in determining whether the company makes profits or not³¹¹. This being the case, the question at issue is not what the consideration should be. The consideration is already determined by one party (the company). The question is the valuation of the payment for the already determined consideration. Suppose a company asks the allottee to pay £10 for ten shares, worth £1 each. The allottee pays \$10 or offers services worth \$10 while knowing or being in a position to know that \$10 is less than £10. Can the court hold that in the situation where payment was made in cash the payment was not what was required, but where it was made in kind, it cannot interfere with the bargain of the parties? We are of the view that in company law this should be regarded as a question of valuation which has nothing to do with principles of consideration.

There are cases which show that courts have 'interfered' where shares were allotted for inadequate non-cash contributions. These cases should not be regarded as exceptions to the general rule, but as a foundation on which legal requirements for valuation of non-cash contributions ought to be based. For example, in Re Wragg Ltd,³¹² A L Smith L.J. was of the view that:

'...if in a registered contract a money value less than the face value of the share be placed upon the consideration which the company had agreed to accept as representing in money's worth the nominal value of the share, that share, I should think, would not be full paid up'.

This view was supported by Lord Macnaghten who also expressed his doubts on the issue of valuation that:

'It was said that if the company limited by shares owes its bankers: £1,000, and its shares are at 50 per cent

³⁰⁹Smith J.C, A Case Book on Contract, (1992), (9th edn.) London: Sweet & Maxwell, at p. 205.

³¹⁰Thomas V Thomas, (1842) 2 Q.B 851.

³¹¹Gower *supra* n. 6 at p. 242.

³¹²[1897] 1 Ch. 796, at p. 836.

discount, fully paid shares of £2,000 nominal value may be given in discharge of the debt.... Speaking for myself, I am not prepared to assent...without further argument'³¹³.

Problems of Valuation at Common Law.

In practice it is always the company which assesses the value of consideration in kind. But the assessment by directors of the company may be superficial because of lack of competence or because of influence by the potential shareholder. For example, in cases where the allottee of shares is the director or his or her nominee. The court ensures that valuation is made *bona fide* in the interests of the company³¹⁴. Thus, where directors do not make any attempt to correlate the nominal value of shares to the value of payments in kind the court does not hesitate to declare the contribution in kind void³¹⁵. However, in other cases when directors have assessed the cash value of the consideration, the court will not set the valuation aside unless it was made *mala fide* or unless it is shown that as reasonable men they could not have concluded that the consideration is equivalent to the amount credited as paid up on the shares³¹⁶.

If the company does not make a genuine assessment of contributions in kind, the court will always regard the allotted shares as wholly unpaid. The allottee is required to pay their nominal value in cash³¹⁷. However, this position is only possible when it is proved that there was fraud or misrepresentation³¹⁸, or if the transaction is voidable because directors have breached their fiduciary duties to the company³¹⁹. Beyond this there is no general rule through which the company or its members can rescind a contract of share allotment in return for consideration in kind when under-valuation is proved. The consequences of this *lacuna* are enormous especially for joint venture companies.

(b) Statutory Law Position.

The Companies Acts of both England and Tanzania require any company with share capital to indicate in its memorandum of association the nominal value of the share capital and that of each share³²⁰. Some company lawyers see this requirement as irrelevant and prefer the provision for minimum share capital for both public and private companies³²¹. The English Companies Act has

³¹³*In Ooregum Gold Mining Company of India V Roper*, supra n. 269, at p 148.

³¹⁴*Pennington* supra n. 25 at p. 150.

³¹⁵*Tintin Exploration Syndicate Ltd. V Sandys*, (1947), 177 L.T 412, at 418.

³¹⁶*Hong Kong and China Gas Company V Glen* [1914] 1 Ch. 527; *Pennington* supra n. 25 at p. 151.

³¹⁷*Re White Star Line Ltd.* [1938] Ch. 458; [1938] 1 ALL ER 607.

³¹⁸*Re Almada and Tirito Co.* (1888), 38 Ch. D, 415 at 423 per Cotton L.J; See also *Re Wragg Ltd* [1897] 1 Ch. 796. at p. 830 per Lindley L.J.

³¹⁹*Re Wedgwood Coal and Iron Co.* (1877) 7 Ch.D 75 at p. 94.

³²⁰Supra n. 290.

³²¹See for example, Gower supra n. 6 pp. 202 - 204; Kahn-Freund, 'Company Law Reform' 7 M.L.R. (1944), 54. at p. 59.

gone further to provide for a mandatory minimum share capital for public companies³²². This requirement does not appear in the Tanzanian Companies Ordinance, despite its potential for controlling the establishment of sham joint venture companies.

The Tanzanian Companies Ordinance is also silent as regards the mode of payment for shares. Whereas section 99(1) of the English Companies Act provides that payment for shares may be made in cash or in consideration other than cash. It goes further to prohibit public companies from allotting shares as fully paid up or partly paid up in consideration or promise which is to be performed, or may, at the option of the promisor, be performed at a time more than five years after the allotment³²³.

Again, according to the English Companies Act a public company, or a private company which is to go public may not allot shares on terms that the whole or part of their nominal value or any premium on their issue shall be paid up otherwise than in cash, unless the consideration has been valued by an independent expert who has reported to the company on its value within six months before the allotment and a copy of his report has been sent to the allottee before the allotment³²⁴.

Although the above position under the English Companies Act indicates that, in the formation of a company, the valuation of a non-cash contribution is necessary, this is limited to public companies. There is no reason why this legal requirement should not be extended to private companies³²⁵. Nevertheless, the English position is more satisfactory than that in Tanzania which does not provide for any valuation in the case of public or private companies. There it could be extended to joint venture companies without problems. Indeed, developing countries need provisions on valuation because many joint venture companies formed in these countries involve significant non-cash contributions.

THE SHARE CAPITAL OF THE JOINT VENTURE COMPANY.

In joint venture companies formed in developing countries, local companies usually provide tangible contributions such as land rights and natural resources, agricultural raw materials, and in

³²²Section 11 and 118(1) of the English Companies Act. This is in accordance with the Second EC Company Directive of 13 Dec. 1976, O.J No. L 26/5.

³²³Section 102(1) *ibid*.

³²⁴Section 103(1) *ibid*.

³²⁵This is because joint venture companies which are regarded as private companies may be formed by two or more public companies. Moreover, we have seen above, *supra* pp. 149 - 151 that the argument that valuation in private companies is rejected because of principles of the adequacy of consideration in contract law may not be used to justify the rejection of compulsory valuation in private companies.

some instances, buildings, plants and machinery³²⁶. The foreign partner (TNC) may provide (apart from capital) intellectual property and sophisticated materials with technical services to operate them. The valuation of these forms of property, to meet the legal requirement to pay the full value of the allotted share capital, pose legal as well as practical problems.

One consequence of the absence of any legal requirement to make an adequate valuation of these contributions in countries such as Tanzania is that valuation is left to the parties themselves. The company's nominal share capital may not correspond to the market value of the shares deemed to be paid-up. Since there is no requirement for a minimum contribution (minimum share capital), joint venture companies may be under-capitalised while showing huge sums of nominal share capital which do not correspond to the contributions in kind, actually made. This may lead, as we shall see later, to the insolvency of the venture and consequently, to its termination.

Secondly, even if there were a legal requirement for valuation, some property might be difficult to value *ex-ante*. For example, if the joint venture is established to exploit natural resources and these resources are regarded as the contribution of a local company or government, it may be difficult to determine the value and quantity of these resources before their exploitation. Therefore, although valuation of these resources is still necessary to determine the contribution of the party concerned, the requirement to correlate them with the nominal values of shares is irrelevant in this case.

Similar problems may be experienced in attempts to determine the value of intellectual property and managerial and technical services for the purposes of capitalisation. In normal licensing or assignment agreements, transfers of such property are paid for by fees or royalties which are deducted from the sales of products produced by the use of the property or services. However, in joint venture companies the same property or services may have to be capitalised for the purpose of determining the share capital. Because of the inherent valuation problems, the paper value of the shares may not represent their real value.

Sometimes it may be agreed that only transfers of intellectual property rights (e.g. patents, trade marks, design rights) should form part of the contribution of the transferor. Because these rights are alien to other venturers, the transferor may enter into separate technical as well as management service agreements with the joint venture company to help in the utilisation of these intellectual property rights. Since these are separate agreements they entitle the transferor to separate fees. Although it is legally possible to separate the value of the technology or know-how (intangible property), which is regarded as the contribution of capital of the transferor to the joint

³²⁶See our discussion in chapter two *supra* pp.11 - 17, re specific or core reasons.

venture, from the services the transferor provides, in practice the separation may not be clear.

4:5:3. MAINTENANCE OF THE JOINT VENTURE COMPANY'S CAPITAL.

It is a general principle of company law that the capital of the company should not be reduced, or altered in a manner which reduces it, unless it is so allowed by law³²⁷. Although it is not the intention of this study to discuss in detail how company law helps to maintain the capital of a company³²⁸, it is nonetheless argued that some characteristic, special to joint venture companies may result in the reduction of joint venture capital, undetected by company law.

According to section 135 of the English Companies Act, a company may if so authorised by its articles, or by a special resolution, reduce its share capital so long as confirmation by the court is obtained under sections 136 - 138 of the same Act. Sections 56 - 61 of the Tanzanian Companies Ordinance also have similar provisions. This reduction of course reduces the liability of shareholders and implies repayment of capital to them³²⁹.

However, the above position does not mean that the company is allowed to reduce its capital through means other than those provided by the law. For example, it has been the position of Common Law since *Trevor v Whitworth*³³⁰, that a company cannot purchase its own shares. It seems the Tanzanian Company Law still applies this position despite some exceptions which may result in share 'watering' - such as issuing shares at a discount³³¹, issuing redeemable shares³³², forfeiting of uncalled shares or over-valuing contributions in kind. But the position in England has changed from that in *Trevor*. Sections 143 - 181 of the English Companies Act provide for some exceptions and lay down procedures through which a company may acquire its own shares. For example, according to section 143(3) a company can acquire, its fully paid-up shares otherwise than for valuable consideration, when it is allowed by the court³³³.

Problems of Maintaining the Joint Venture Capital.

³²⁷Gower supra n. 6 at p. 211.

³²⁸For further discussion see Gower ibid. at pp. 211ff; Pennington, supra n. 25 at pp. 169 - 199.

³²⁹Gower ibid. at p. 212.

³³⁰(1887) 12 App. Cas. 409, (H.L.)

³³¹See sections 44, 47, and 48 of the Tanzanian Companies Ordinance.

³³²Section 47 ibid.

³³³See Gower supra n. 6 at p. 213.

The joint venture company's capital like the capital of any other company is supposed to be maintained unless it is reduced in a manner allowed by law. However, in some joint venture companies, because of the nature of the capital contributions, it may be difficult to detect acts which reduce capital.

The capital of the joint venture company is actually reduced when shares are paid by over-valued non-cash contributions. This is because it is difficult to value *ex-ante* some of the venture's contributions. Thus, the joint venture may operate with high nominal capital and engage in risky and expensive projects only to end up in termination, because of insolvency³³⁴.

The second factor which may reduce the capital of the venture arises from the fact that, while company law does not recognise managerial skills and labour as capital investments, they are invested in joint venture companies as contributions in kind in the form of technical or managerial services which accompany technology transfers. Although such services may be contributed to the venture on the basis of collateral agreements with fees paid separately³³⁵, it may be difficult to make a distinction between the technology which is transferred to the joint venture company as a capital contribution and the services ancillary to that technology which is provided by the same contributor for a fee under a separate contract³³⁶.

Some possible solutions: Lifting the veil of incorporation.

The concept of lifting the corporate veil of a company deals with the circumstances in which the legal rights which are accorded to companies may be disregarded so as to attack individual members or parent companies³³⁷. In most cases this doctrine is applied to protect creditors when the right of limited liability is misused. It enables them to recover from individuals or member companies who intended to use this right to escape liability³³⁸. Sometimes, however, the doctrine may be used to protect companies or individual members³³⁹. The doctrine is based on the concept that the corporate entity which is granted to the company should not be misused to hide certain dubious intentions.

³³⁴See *infra* pp. 161 - 164.

³³⁵See for example, 'supplementary agreements' discussed *supra*, pp. 95 - 97, see also chapter six *infra* pp. 234 - 242, and appendix 1.

³³⁶See for example, Article 5 of the Joint Venture Agreement for the Establishment of The New Sugar Company in Tanzania, (1990) discussed in chapter six *infra* pp. 232 - 233, see also clause 4.1 of appendix 1.

³³⁷Gower *supra* n. 6 at pp. 108ff.

³³⁸Easterbrook F. and Fischel D. 'Limited Liability and the Corporation', 52 U. Ch.L.Rev. (1985), 89, pp. 109 - 113, at p. 113 they argue that under-capitalisation may tempt the organisers of capital to engage the company in excessively risky activities than its liability.

³³⁹See for example, D.H.N Foods Distributors Ltd. V Tower Hamlets, [1976] 1 W.L.R 852.

The doctrine of piercing the veil of incorporation is the only available general remedy which ensures that companies are not under-capitalised and that when they are under-capitalised parent companies or individual members bear the responsibility³⁴⁰. It seems that, subject to some reservations³⁴¹, this doctrine may be used to check the under-capitalisation of joint venture companies.

In trying to apply this doctrine, the courts have found themselves entangled between two extremes. On one side is the argument that after incorporation the company becomes a legal entity. Reluctance to deny the entity still has some influence. Yet, on the other side reality shows that: "the court will use its power to pierce the corporate veil if it is necessary to achieve justice irrespective of the legal efficacy of the corporate structure"³⁴². For example, when it is proved that the circumstances of business relationship in a group of companies (which are supposed to operate as independent legal entities) show that the business is conducted as a single economic unit, the court may treat that group as a single company. Therefore, in this sense, the veil of incorporation of one company (the subsidiary company) may be disregarded and the parent company may be attacked³⁴³.

Sometimes courts have disregarded the corporate status of the company when it was discovered that the company was established as 'a mere facade' to hide the fraudulent intent of the incorporators. For example, if the company is established to shelter individuals or member companies from an existing liability or from the need to fulfil certain legal requirements³⁴⁴.

The court may also lift the veil of incorporation where the company acts as the agent of some incorporators, being a parent company or individual members. In this case the parent company or the individual member is in the capacity of a principal of that company, not a member³⁴⁵.

However, the English position as regards lifting the veil of incorporation is just an exception to the general rule that the corporate entity cannot be denied. This position was emphasised in the

³⁴⁰Easterbrook and Fischel supra n. 338, at p.; Blumberg Phillip, The Multinational Challenge to Corporation Law, (1993), Oxford: Oxford University Press, pp. 65 - 88, especially at p. 66.

³⁴¹See our discussion infra pp. 158 - 159.

³⁴²Re A Company Ltd., (1985) B.C.L.C, 99.421 (C.A).

³⁴³See Gower supra n. 6 at p. 126; See also D.N.H Foods Distrubutors V Tower Hamlets, supra n. 304, especially the argument by Lord Denning, pp. 857 - 860; Compare with Woolfson V Strathclyde R.C (1978), S.L.T, 159, per Lord Keith, at p. 161.

³⁴⁴Jones V Lipman, [1962] 1 W.L.R, 832.

³⁴⁵In this case agency cannot be implied as it was attempted in Salomon V Salomon & Co Ltd., there must be an express contract to that effect; See for example, Southern V Weston [1950] 3 ALL ER 439 (C.A); Rainham Chemical Works V Belvedere Fish Guano Co. Ltd. [1921] 2 A.C 465, (H.L)

case of *Adams and others V Cape Industries PLC and another*³⁴⁶ where the respondent company, an English company dealing with mining and selling asbestos materials had established a subsidiary known as N.A.A.C to market its products in Illinois, America. After the latter company had spent a lot of money compensating its employees, the respondent company decided to liquidate it and form another subsidiary known as C.P.C, in order *inter alia* to reduce future liabilities. In bringing action against the respondent the appellants argued that C.P.C and Cape industries were one and the same company and that C.P.C was established to enable Cape Industries escape liability. It was held, in dismissing the appeal, that since C.P.C was not established as a *facade* to conceal the true facts, it was not appropriate to pierce the corporate veil. Further, that C.P.C was established to take over the business of N.A.A.C which, according to the evidence given, had a substantial independently operated business³⁴⁷.

The concept of lifting the veil of incorporation originated from, and is more developed in, America than in any other country³⁴⁸. In America the corporate entity can be disregarded in several circumstances³⁴⁹. As regards the maintenance of the company's business the American legal position is that: if the corporation is organised and carries on business without a substantial capital in such a way that the corporation is likely to have insufficient assets available to meet its liabilities, the court may lift its veil of incorporation on the basis of under-capitalisation³⁵⁰.

The American position, to some extent, resembles the position of some Continental European countries³⁵¹. For example, the German Company Law provides a wide range of circumstances in which the veil of incorporation may be ignored. These include; (a) where a sole or a controlling

³⁴⁶[1990] Ch. 433.

³⁴⁷at pp 536 - 537 their Lordships held that: 'Our law, for better or for worse, recognises the creation of subsidiary companies, which though in one sense the creatures of their parent companies, will nevertheless under the general law fall to be treated as separate legal entities with all the rights and liabilities which will normally attach to separate legal entities.....In deciding...the court is entitled, indeed bound, to investigate the relationship between the parent and the subsidiary...[this] may be relevant in determining whether the subsidiary was acting as the parent's agent and, if so, on what terms....If a company chooses to arrange the affairs of its group in such a way that the business carried on in a particular foreign country is the business of its subsidiary and not its own, it is,...entitled to do so'.

³⁴⁸For a detailed discussion of the doctrine in American Company Law see Gelem G. Morris, 'Piercing the Corporate Veil in Louisiana' *52 Lous.L.Rev.*, (1991), 271; Berle, 'The Theory of Enterprise Entity as a Solvent of Legal Problems', *34 Mich.L.Rev.*, (1936), 59; For an economic account of the doctrine, see Easterbrook and Fischel, *supra* n. 338; Thompson, 'Piercing the Veil: An Empirical Study' *72 Corn.L.Rev.* (1991), 1036; Michel Whincup, 'Inequitable Incorporation' *2 Company Lawyer*, (1981), 158.

³⁴⁹For example, in situations where there is excessive financing by the parent company, payment of the subsidiary expenses by the parent company, description by the parent company of the business of its subsidiary as its own, the fact that the subsidiary has no business except those of the parent, etc. see generally Whincup *ibid*, at p. 161.

³⁵⁰*Ibid*. at p. 161; See also Cohn J.E and Simitis C., 'Lifting the Veil of Incorporation in Company Law of Continental Europe', *12 I.C.L.Q.*, (1963) 189, at p. 225., they argue that if this would have been a consideration *Salomon V Salomon & Co Ltd.* would have been decided differently.

³⁵¹For example Germany, France and Italy, see Cohn and Simitis *ibid*.

shareholder fails to distinguish between the assets of the company and his own. (b) Also in cases where a debtor of one company is the creditor of another and are both owned by the same shareholder, German courts have held that both the debtor and the creditor are one and the same company³⁵². German law also allows the lifting of a corporate veil in cases of fraud or lack of good faith in dealings where one company controls another³⁵³.

With the emergence of more complex business associations such as joint venture companies, there are indications that the concept of piercing the veil of incorporation is construed more liberally³⁵⁴. It tries to reconcile the existence of a company as a separate legal entity with its existence as an economically independent entity. Cohn and Smmitis³⁵⁵ agree that the circumstances of business in which legal personality was accorded to the company in the 19th century have changed. Business relationships of the twentieth, (and, one may anticipate, of the twenty first century), are dominated by interdependence. Because of interdependence and continuous negotiation companies can easily move or force others into dependency. The law should recognise this tendency and seek the reality of economically independent entities as enterprises. The discussion on groups of companies has shown that companies may establish companies as joint venture companies in legal terms, who, if economic considerations are disregarded, can act as mere 'dummies' of the stronger companies which create them. It is in this sense that the concept of lifting the veil of incorporation becomes very important to joint venture companies formed in developing countries.

However, there is a need to balance the doctrine of piercing the veil of incorporation with the long-term objectives of allowing the formation of joint venture companies. For example, if the doctrine of lifting the veil of incorporation is applied strictly investments will be discouraged because it will affect the scope of the limited liability of joint ventures, the advantage which joint venture companies are established to enjoy. Moreover, when the veil of incorporation of cross-national joint venture companies is lifted practical as well as legal problems of attacking foreign members should be anticipated³⁵⁶.

4:5:4. PROFIT DISTRIBUTION IN THE JOINT VENTURE COMPANY.

³⁵²Ibid. pp. 190 - 204.
³⁵³Ibid. p 203.
³⁵⁴Blumberg supra n. 340, at pp. 90 - 96.
³⁵⁵Supra n. 350, at p. 192.

³⁵⁶For an attempt to tackle the problems of cross-national companies by using the principle of lifting the veil of incorporation see UN, World Investment Report: Transinational Corporations and Integrated International Production, (1993), New York: United Nations Press, pp. 196 - 201. The discussion on cross-national joint venture companies is provided in the next chapter infra.

Another element in the maintenance of the business of the joint venture company is the balance between the long-term objectives of the venture and the short-term gains of the members. One of the functions of the legal requirement for nominal share capital is the provision of a mechanism or yardstick to determine whether a company has lawfully made distributions to its members (i.e., it has paid dividends out of profits)³⁵⁷. Further, the purpose of the capital maintenance rules is defeated if dividends are paid despite the fact that the value of the net assets of the company is, or would become as a result of payment, less than the value of the nominal capital of the company³⁵⁸, to the point of endangering the position of creditors of the company. For these reasons, company laws try to prohibit payments of dividends out of capital. However, this prohibition may become useless if it is not known in the first place what exactly the value of the nominal capital of the company is, as may be the case in joint venture companies.

The current English Company Law position allows profit distribution of the company to be made in cash or otherwise³⁵⁹. The profit has to be calculated out of accumulated realised profits³⁶⁰. The Tanzanian position is not yet clear. There is no provision in the Companies Ordinance to that effect. Therefore, as far as the distribution of profits is concerned, the Tanzania Company Law applies the Common Law position.

The Common Law position was made clear in the case of *Dimbula Valley (Ceylon) Tea Company V Laurie*³⁶¹, which, apart from holding that dividends have to be declared out of profits, like earlier cases³⁶² it went on to hold that, subject to the provisions in the articles of association of the company, the calculation of dividends should be based on the profits made within each year without regard to previous loss. This position presents an unrealistic picture of the company's business and may damage the position of creditors whom it was intended to protect. For it may involve payment out of capital in so far as the accumulated losses are not written off in the reduction or reorganisation of the company's capital to reflect the true value of the assets of the company. Moreover, it is not clear whether it allows distribution in kind, a feature which is common in joint venture companies.

In normal joint stock companies once a member has paid for its shares either in cash or in kind, it ceases to be a legal owner of what it has paid. All the assets contributed belong to the company. Members' ownership and legal titles thereto exist only in shares which they hold in the company.

³⁵⁷See Gower *supra* n. 6 at pp. 221, 242.

³⁵⁸*Ibid.* p. 221.

³⁵⁹Section 263 of the English Companies Act, 1989.

³⁶⁰Before the 2nd EEC Company Law Directive, it was distributed out of the year's profits.

³⁶¹[1961] Ch. 353.

³⁶²For example, *Re Crichton's Oil Co.* [1902] 2 Ch. 86; *In Re Odessa Waterworks Co. Ltd.* [1901] 2 Ch. 190; *Bishop V Smyrna and Cassaba Railway Co.* [1895] 2 Ch. 265; *Birch V Cropper* (1889) 14 App. Cas. 525.

Therefore, the distribution of profits can only be made in cash, except in cases when the company is wound up or de-merged³⁶³, when distribution may be made in kind. However, according to the English Companies Act, distribution in kind is not limited to these situations.

Non-cash distribution may commonly arise in joint venture companies. This is because the objects and reasons for the establishment of joint venture companies mainly aim at getting unrealised profits which can be used by members to generate profits on their own³⁶⁴. Therefore, there may be no need for a formal declaration of dividends in the joint venture company. However, the valuation of non-cash distributions may present the same difficulties as the valuation of non-cash contributions. Moreover, the transfer or acquisition of technology of the joint venture company to or by its members has to obey laws of intellectual property³⁶⁵.

Thus, joint venturers may have to reach agreement on the distribution of profits from the joint venture company which are different from the normal dividend policies. For example, parties may include in their joint venture agreements provisions requiring venturers to 'buy back' the products of the joint venture company³⁶⁶. Some agreements may include formulae for profit distribution which may change, depending on the depreciation or appreciation of the contribution of each party³⁶⁷.

4:6. TERMINATION OF THE JOINT VENTURE COMPANY.

Termination of the joint venture company is not necessarily the same as its dissolution. A joint venture company may cease to exist *qua* a joint venture company but continue to exist *qua* a (subsidiary) company. Termination of a joint venture company implies two situations: (a) the withdrawal of one or more of the joint venturers, in which case the company may continue to operate but not as a joint venture company, or, (b) the withdrawal of all of the joint venturers, in which case it amounts to dissolution of the joint venture company³⁶⁸.

As we have seen, when members of a joint venture are in disagreement the best solution may be

³⁶³Gower *supra* n. 6 pp. 244, 256 - 257.

³⁶⁴See our discussion in chapter two *supra* pp.9 - 27.

³⁶⁵See for example, Bainbridge, *supra* n. 297. and Cornish, *supra* n. 297, for a discussion on intellectual property law.

³⁶⁶See for example, Moser, Michael, (Ed.), Foreign Trade Investment and the Law in the Peoples Republic of China, (1987), Hong Kong: Oxford University Press, at pp. 181 - 182 he indicates that the Chinese joint ventures use this method.

³⁶⁷*Ibid.* at pp. 124 - 125.

³⁶⁸See Ashurst Morris Crisp, et al., Joint Ventures in Europe, (1991), London: Butterworths, at pp. 253 - 257; Stedman Graham and Jones Janet, Shareholders Agreements, (1990), (2nd. edn.), London: Longman, p. 197.

to achieve an amicable termination of the venture³⁶⁹. However, it does not necessarily follow that parties should terminate their joint venture company only when they are in disagreement. They may decide to do so when the purposes for which one or more of the members established it cease. Thus, whereas normal companies may have an unqualified perpetual existence, the perpetual existence of the joint venture company depends on the presence of co-operative elements, particularly complementary interests, profit and loss sharing, and joint control.

4:6:2. JOINT VENTURE TERMINATION AND COMPANY LAW.

Termination resulting in another type of a company

This includes situations where one or more parties sell or transfer their shares to other parties, leaving the business of the company in operation. It may include the following situations: (i) When one party leaves because of a deadlock situation; (ii) When one or more of the parties no longer wish to continue the relationship with the remaining party or parties³⁷⁰; (iii) When there is a breach of a fundamental term in the joint venture shareholders' agreement. Although as argued elsewhere in this chapter, the breach may be remedied under the laws of contract³⁷¹, it may also affect the rights of other members in the company. The affected party may decide to leave the venture; (vi) The position of the joint venture may also results in its termination when one or more of the joint venturers becomes insolvent; (iv) Joint venture companies may also be terminated when mutual control is 'watered' or 'saturated'. This may take place whether or not the transfer of shares is allowed. If transfer is restricted other members are in the position of buying out the weaker member. If transfer is not restricted, 'outsiders' or 'third parties' may buy shares from one or more joint venturers and therefore 'water' the balance of joint ownership and control within the venture.

When such situations arise in a joint venture company, the parties most affected may decide to sell or transfer their shares. However, company law rules have to be obeyed. Joint venture companies, just like private companies or closed companies, have complicated procedures of share transfer. The transfer of shares in these companies may be restricted in some jurisdictions³⁷². Shares can only be transferred by the use of one of the following means:

³⁶⁹See supra p. 122.

³⁷⁰Stedman and Jones, supra n.368 at p. 194, refer to this situation as boredom.

³⁷¹See supra pp. 95 - 97.

³⁷²See section 27(1) of the Tanzania Companies Ordinance; Generally see Pennington supra n. 25 at pp. 752 - 759.

(a) The first method is by utilising the company law principle of 'pre-emption'³⁷³. The concept behind this principle is straight-forward. A member wishing to transfer shares is first required to offer them to other members of the joint venture company. This creates a new type of shareholders' relational right - the pre-emption right. However, as we have seen elsewhere in this chapter, the transfer of shares is an individual right of the shareholder³⁷⁴. Therefore, the court does not allow the denial of this right unless it is included in the articles of the company in a clear and unambiguous language. For example, in a case where a member transferred his equity title on shares but still held a legal title, the court did not hesitate to hold that, that transfer had no legal effect on his shares³⁷⁵. Further, the court will imply such terms as may be necessary to give business efficacy to the obvious intentions of the parties. For example, where members were required to serve a 'transfer notice' on other members before they transferred their shares to outsiders, a transfer which did not obey that requirement was held to have no effect³⁷⁶.

In summary, Common Law indicates that there is a need for the use of a careful language in drawing up pre-emption clauses. However, the exact wording of such clauses will depend upon the circumstances of each company and each case. It is very important to be clear on the pricing of the shares to be transferred. Sometimes the clause may restrict the transferor who proposes the offer price not to sell shares on a lesser price to outsiders when the original price is rejected by other members, unless the transferor also gives the offer notice of the reduced price to the members first³⁷⁷. In some cases where the shareholder offers its shares to outsiders but the offer is rejected, the offeror may be required by the clause to accept the price proposed by the auditor of the company or any valuer employed by the company³⁷⁸.

However, not all circumstances in which shares are transferred will lead to the termination of the joint venture company. The venture may be salvaged if the remaining parties are still interdependent and the shares are transferred proportionally³⁷⁹. The joint venture may survive also where shares are transferred to a member within a class while joint ownership and control within the venture is determined on class basis³⁸⁰.

The joint venture company may also be saved if the pre-emption clause gives rights to members to

³⁷³See sections 89 - 96 of the English Companies Act, 1985 on pre-emptive rights and allotment by the company.

³⁷⁴See supra pp 107 - 108.

³⁷⁵Safeguard Industrial Investment Ltd. V National Westminster Bank Ltd. and another, [1982] 1 ALL ER, 449, (C.A).

³⁷⁶Lyle & Scott Ltd. V Scott's Trustees, [1959] 2 ALL ER, 661.

³⁷⁷Stedman and Jones, supra n. 368 at pp. 26 - 27, 194.

³⁷⁸Ibid. pp. 26 - 27. See also appendix 1, clause 6.

³⁷⁹Ashurst Morris Crisp et al. supra n. 368 at pp. 253 - 254.

³⁸⁰See supra pp. 115 - 116.

nominate who may buy the shares, based on the ability of the prospective buyer to perform the offeror's obligations in the venture. This is one of the advantages of joint venture companies over joint venture partnerships which under partnership laws, termination or the cessation of one member's membership amounts to the termination of the whole venture³⁸¹. For the same reasons, directors of the company may be empowered by the articles of the company to refuse to register the transfer of shares until the transferor finds a party whose interests in the joint venture allow the joint venture company to continue³⁸².

If the above methods of salvaging the joint venture company do not succeed, shares have to be transferred to one of the members or to an outsider. This may disturb the balance of mutual ownership and control to the extent that the company will no longer be a joint venture company. It may be regarded as a subsidiary company of the shareholder who controls it³⁸³.

(b) Another way of terminating the joint venture company by changing it into another type of a company is by utilising the Company Law provisions for compulsory transfers³⁸⁴. According to company law there is compulsory transfer of shares whenever the shareholder becomes incapacitated³⁸⁵. In the joint venture company's case compulsory transfer may be exercised when one of the member companies becomes insolvent and is in the process of being wound up. Arrangements have to be made with the receiver or liquidator of that member to make it possible for its shares to be transferred to other members. Although this may not be easy in cross-national joint venture companies³⁸⁶.

(c) The third method of terminating the joint venture company without dissolving it is by the use of what is known as 'buy and sell option', (sometimes referred to as 'Russian roulette', or, 'Savoy' or 'Texas shoot out')³⁸⁷. This may be more appropriate to joint ventures with two members. However, it can be applied to ventures with more than two members when the selling or the buying is applied proportionally. In short, this method involves a procedure whereby one party who wants to leave the joint venture company gives a notice to the other(s): [1] offering to buy the shares of the other party or parties at a specified price in the notice; or, [2] offering to sell its shares to the other party or parties at the same price (i.e., the price specified in the notice under [1]). The party or parties receiving the notice are entitled within a set period to elect either to sell

³⁸¹See our discussion in chapter two pp. 40 - 46.

³⁸²Stedman and Jones, *supra* n. 368 at p. 27.

³⁸³See our discussion on group of companies in chapter three *supra* pp. 77 - 80.

³⁸⁴However, it should be noted that a special provision in the constitution of the joint venture company is required for these provisions to operate.

³⁸⁵Stedman and Jones *supra* n. 368, at pp. 31 and 194.

³⁸⁶Because of the problems of extraterritoriality, see Blumberg *supra* n.340 at pp 168 - 201.

³⁸⁷Ashurst Morris Crisp et al. *supra* n. 368 at p. 253; See also clause 6 of appendix 1 *infra*.

their shares to the first party or to buy the shares of the first party at the set price.

This procedure aims at ensuring that members are committed to the joint venture company when they decide to establish one. Thus, they should not leave the joint venture company without good reasons. This is because by deciding to establish the joint venture company each party is bound to the venture not only because of its own interests but also because of the interests of other parties. Further, that when it decides to leave, its departure should be seen as fair by all the parties³⁸⁸.

The above method, however, may itself be unfair to some members in certain circumstances. For example, one party may be bought out because it cannot meet the price offered by the other party, though it may wish to stay in the venture. Thus, this method may work unfairly to joint venturers of unequal financial strength³⁸⁹.

Termination resulting into the dissolution of the joint venture company.

There are situations which may terminate the joint venture company both *qua* a joint venture and *qua* a company. These include: (i) When the joint venture fails. For example, when it becomes insolvent; (ii) When the contributions of members were over-valued or the joint venture company was under-capitalised and the parties do not wish to provide further finance. Failure by the parties to provide further finance or to secure outside loans may render the joint venture company insolvent; (iii) When the joint venture company has a limited purpose, after that purpose has been accomplished, parties may decide to terminate the joint venture company; (iv) When there is a deadlock but no party is ready to leave unless the venture is liquidated.

In Company Law such situations lead to the winding up and liquidation of the joint venture company, using the procedures applicable for winding up other companies. The subject matter of corporate winding up and liquidation is very extensive and is well treated by eminent company law writers³⁹⁰. Moreover, it is not the intention of this study to analyse it. Nevertheless, it is important to this study to observe that, for cross-national joint venture companies, the process of winding up and liquidation may pose a number of legal and practical problems if not agreed *ex-ante*. For example, problems about how to share some of the tangible and intangible contributions by the parties to the joint venture company under liquidation may arise³⁹¹. International legal

³⁸⁸Ibid. p. 253.

³⁸⁹Ibid. p. 254; When one considered the joint venture under discussion, namely between companies from developing countries and TNCs it is clear that this method cannot work properly.

³⁹⁰See for example, Snaith Ian, The Law of Corporate Insolvency (1990), London: Waterlouw; Gower Supra n. 6, Ch. 28 pp. 743 - 785.; Farrar supra n. 2 Chs. 36 - 39, pp. 647 - 722, to mention but a some.

³⁹¹See for example, the dispute on the division of assets between former joint ventures partners in B. I. I C plc.

efforts to solve the problems of cross-national joint ventures are analysed in the next chapter.

4:7. SUMMARY AND CONCLUSION.

This chapter attempted to show how company law applies to the joint venture company. Its analysis was based on the argument developed in the previous chapters that in order to maintain complementarity of interests, profit sharing and joint control, company law must emphasise the importance of forming and maintaining the company as an enterprise. In company law terms enterprise principles may be reflected in the regulation of negotiations between the joint venture company's actors before and after its formation and in ensuring that the company has adequate business throughout its operations.

Although company law regards company promotion as a separate preliminary business activity, joint venture company promoters are at the same time the prospective members. Thus, the Common Law promoters' duty of disclosure and accounting to the company may be inadequate to regulate promoters of the joint venture company. This is because directors of the joint venture are employed to protect members' interests. As such, they may not be independent in representing the interests of the company as a whole. Further, disclosure of this kind may look unfair in situations where the management is provided by one joint venturer. Therefore, in the joint venture company situation, rather than imposing a duty of disclosure to the company (directors) it may be appropriate to disclose to other members. For the same reasons the ratification of pre-incorporation contracts by promoters should be made by all members, not by the company directors.

The most important stage of the joint venture company's incorporation is the adequate negotiation of its constitution (memorandum and articles of association). This is so not only because the memorandum and articles of association are the only documents recognised by company law for company formation, but also because they provide a legal framework on which the balance of parties' interests and maintenance of business of the joint venture company should be based. The constitution of the joint venture company should therefore be read in conjunction with any shareholders' agreement or other documentation put in place by the parties to regulate the joint venture³⁹².

In order to meet the requirement of maintaining complementary objectives and contributions, the

V Burndy Corporation and another, [1985] Ch. 232.

³⁹²Linklaters and Paines, *Joint Ventures*, (1990), London: Longman, p. 41.

memorandum of association of the joint venture company should be more specific. For example, it should define the ambit of the company's activities as between venturers themselves. Company law which is not flexible in the alteration of the memorandum of association may occasion the drafting of the object clause in a very broad manner so as to cover the majority of future acts of the company. The effect of this on the joint venture company is that in most cases the memorandum of association does not reflect the definite objects of the venture. In such a situation it is not uncommon to find that only the joint venture shareholders' agreement reflects the objects of the venture. Although some writers³⁹³ argue that shareholders agreements should be compulsorily registered, we think changes which have been introduced in the English Companies Act with the effect of allowing the alteration of the memorandum of association and reforms in the *ultra-vires* doctrine may solve a great deal of the problem. These changes are yet to be introduced in the company laws of Tanzania.

Articles of association are a vital document to the joint venture company. They present a legal mechanism for joint control and profit sharing. As such, they may not be similar to those provided under Table A of the Companies Act. However, the legal requirement that nothing should prevent the company from altering its articles may affect the element of joint control. This is because in order to maintain joint control most decisions in the joint venture company have to be made unanimously. Parties ensure that equal participation in decision making is maintained either in the articles or in separate agreements. The legal position that such agreements are enforceable as between members *inter-se*, but not enforceable against the company may be difficult to grasp in the joint venture company situation.

The need to maintain joint control also affects the way the constitution and the law protect or balance joint venture members' interests - that is, the protection of equality of members' bargaining power. The effectiveness of company law in protecting all interests, whether minority or majority and in maintaining bargaining equilibrium between them is therefore something upon which a great deal of attention should be focused. The constitution or a separate agreement alone, unaided by company law, may be inadequate. Firstly, in most cases the so called "*Bushell V Faith* clauses" which are included in the constitution or in the shareholders agreements (e.g., 50-50 share-holdings, weighed (class) votes, and golden shares) may result in a deadlock. This may damage the business of the joint venture company, if affected parties are not allowed to seek court's assistance to break the deadlock. Secondly, because the law is unclear on constitutional alterations, some members may seek to alter the original joint control as provided in the constitution or in separate agreements at the expense of other members' interests.

³⁹³See for example, Mercer Colin, "Does a Shareholders' Agreement Require Filing with the Registrar of Companies?", 15 *Co. Law*, (1994), 19 - 21.

For these reasons the English company law position has shifted away from the rule in *Foss V Harbottle*. Section 459 of the Companies Act has been introduced to enable any member to apply to the court on the ground that the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of the company or of some members, including itself. Also, section 122 of the Insolvency Act, (1986) provides for the winding up of the company when it is just and equitable to do so. As these provisions do not appear in the laws of Tanzania, the constitution and the joint venture shareholders' agreements remain the only legal means for maintenance of joint control.

However, the above provisions only offer protection to members *qua* shareholders. This study argues that because of interdependent contributions, the notion of joint ownership and joint control in the joint venture company should not be limited to shareholders. It should include other 'members' whose contributions are vital to the survival of the venture. For example, in developing countries the contributors of managerial skills and technical know-how are regarded as important participants and can affect the balance of control if overlooked. The absence of a legal recognition of this fact forces most joint venture companies to offer the provider of managerial skills and technical know-how 'free' shares to enable them to participate in the decision making of the company. This procedure, apart from increasing confusion in notions such as "*qua* members", "*qua* directors" or "shadow directors", avoids the fact that managerial skills and technical know-how are a type of property and are invested in joint venture companies formed in developing countries for purpose of generating profits. The use of management and technical services agreements as part of the shareholders' agreements to supplement company law, as will be shown in the sixth chapter, proves this conclusion. Moreover, the reluctance to recognise the contributions by the management and employees as things which grants them membership in their right adds to a partial understanding of the concept of ownership and control as enunciated by Berle and Means and later expounded by Herman. This may further confuse the concept of joint ownership and joint control in the joint venture company. Indeed the idea that a joint venture company is only one in which there is a 50-50 share-ownership is a result of this misunderstanding.

Section 309 of the English Companies Act which requires and enables the management to consider both the general interests of employees and specific interests of shareholders may be a step towards the recognition of employees' contribution. But the practical application of the section is doubtful. This is because, apart from being 'general' when talking about employees, it is, unlike in the case of shareholders, not supported by further provisions to indicate what these interests are and how they should be considered or protected or allowing individual employees to

sue.

As far as the recognition of managerial skills is concerned the legal position is not clear either. While practice has shown that there are directors who join the company because of their managerial skills and there are those who join in order to protect the interests of shareholders, English and Tanzanian company law generalises the role of both categories of directors. Although the Cadbury Committee Report recognises this fact, it does not cover the participation of employees in its proposal. Therefore, it does not present a comprehensive solution. The notion of joint control and joint contribution in the joint venture company cannot be understood unless company law provides for the representation of shareholders, management and employees in the decision making of the company. This may be effected by considering the adoption of the 5th EEC company law directive which creates *inter alia* a two tier board system or a single tier system which represent the interests of all constituencies. The former system may be appropriate to joint venture companies whereby managerial services are provided by one joint venturer, as it is the case in most developing countries, including Tanzania. In the absence of a management structure such as this, management and technical services agreements, as will be shown in the sixth chapter, will continue to be used to supplement the law.

The regulation of members' interests may be useless unless company law ensures that the joint venture company has and maintains a business. This is especially important when one considers that in most joint ventures contributions are made in kind. Issues like the effective date of asset transfers and their valuation in order to meet the requirements for issuance of shares for full and adequate consideration have to be addressed. Also, as the *ex-ante* valuation of contributions such as land, minerals and intellectual property may be difficult to make, formulae for their *ex-post* adjustments when a true value is known may be necessary³⁹⁴.

Problems encountered in the contribution of capital assets may also arise in the distribution of profits. While it is a norm in other companies for profits (dividends) to be distributed in cash, in many joint ventures members are interested in the products of the joint venture, not in their cash value. Therefore 'buy-back' arrangements may be necessary.

Unlike Tanzanian company law, English company law recognises the fact that a contribution to the company may not necessarily be made in cash. Section 99(1) provides that shares may be allotted for non-cash consideration, including intangible assets like goodwill and know-how.

³⁹⁴For example, providing for cash compensation when the value of assets is ascertained. If this is undesirable, then it may be necessary for the other party to adjust its contribution to bring about the desired result in terms of relative shareholdings. This should include the possibility of appreciation and depreciation of some assets over a certain period of time.

However, it limits the requirement for compulsory valuation to contribution in kind in public companies. Neither does Common Law support compulsory valuation in private companies. This study has made a case for the introduction of compulsory and independent valuation in private companies in order to ensure adequate valuation of shares for non-cash contributions in joint venture companies. Otherwise, joint ventures in developing countries are likely to face premature termination because of under-capitalisation.

The only remedy for under-capitalisation, namely lifting the veil of incorporation has its own shortcomings. Firstly, in countries such as Tanzania and England it operates as an exception rather than a rule. Secondly, full application of the concept may damage the privilege of limited liability which most joint ventures are established as companies to enjoy. Thirdly, in cross-national joint ventures the concept of lifting the veil of incorporation may be difficult to apply because of the problem of extra-territoriality. The latter problem may also be an obstacle to many other aspects of company law which involve "enterprise" principles. For example, the general fiduciary duty, the duties of shadow directors and the concept of groups of companies may be difficult to apply to foreign parent companies in a situation where company law is limited to a single nation. This means that co-operation between different countries is needed to provide for a "proper" legal framework for cross-national joint venture companies. The next chapter will assess international legal efforts to this end.

CHAPTER FIVE.

THE INTERNATIONAL LEGAL CONTEXT OF JOINT VENTURE COMPANIES.

5.1. INTRODUCTION.

The UN acknowledges the role of cross-national corporations (TNCs) in the implementation of economic development resolutions for the developing countries¹. While this recognition remains important, it is equally important to analyse the efforts which have been made to ensure that the relationship between TNCs and companies from developing countries (in our case, in joint venture forms), achieve the ends of development. UN documents and those of other international organisations must promote the basic elements necessary for the establishment of joint ventures, namely: interdependence and co-operation, expressed by complementarity, joint control and profits sharing. This in turn will ensure that the promised 'development rights' which appear in various UN documents and resolutions are not abused through the very joint venture company mechanisms which are established to spearhead them. In this chapter the idea of interdependence and co-operation is expanded to include not only specific regulations on the internal relationships of cross-national joint venture companies, but also the wider context of international legal efforts to that effect. The objective is to analyse whether international trade law tackles those issues raised by cross-national joint venture companies which, as we have seen in the last chapter, are beyond the ambit of the company law of a single nation.

5:2. THE INTERNATIONAL TRADE LAW AND JOINT VENTURE COMPANIES.

5:2:1 The General International Legal Framework.

¹UNCTAD, International Market Power of Transnational Corporations, (1978), New York: UN Press; Asante Samuel, K.B, 'United Nations Efforts at International Regulation of Transnational Corporations', in Hossain Kamal (Ed.) Legal Aspects of the New International Economic Order, (1980), London: Frances Pinter (Publishers) Ltd. at p. 123; United Nations, The World Investment Report: TNCs as Engines of Growth, (1992), New York: UN Press, pp. 202 - 203; Generally see, United Nations, World Investment Report: Transnational Corporations and Integrated International Production, (1993), New York: United Nations Press.

The analysis of the International regulatory framework for cross-national joint venture companies inevitably has to start with the analysis of the International Public Law, since it is from this law that International Economic Law derives². Although there have been several attempts to provide an international legal framework for international business relations, almost all have their common denominator in the United Nations regulatory framework. Indeed, developing countries used the United Nations Organs to fight for the New International Economic Order (NIEO), which emphasises the development of co-operative business entities and the regulation of the behaviour of transnational corporations. Some other International institutions such as the GATT and the EEC - ACP dialogue have also influenced the shape of these efforts.

Perhaps the starting point is the United Nations' three NIEO documents, namely: the Declaration on the Establishment of the New International Economic Order³, the Programme of Action on the Establishment of a New International Economic Order⁴, and, the Charter of Economic Rights and Duties of States⁵. It has been observed that these documents mark the end of "the traditional handouts of financial aid and technical assistance, and for an end to the vagueness of resolutions dealing with redressing of (sic) the balance between the have[s] and have-not[s]"⁶. The documents represent a comprehensive series of norm-creating statements, at the international level, on the new international economic order (NIEO)⁷. Although as far as the regulation of cross-national joint ventures is concerned the above observation may be an overstatement, these documents set a general background against which the analysis of the specific regulation of cross-national joint venture companies may be judged.

The Declaration on the Establishment of the New International Economic Order is aimed at establishing the NIEO based on equity, sovereign equality, interdependence, common interest and co-operation among States. In particular, as far as co-operation and interdependence are concerned, the declaration acknowledges that:

²See Jackson John, H. and Davey William, J., Legal Problems of International Economic Relations, (1986) (2nd edn.), Minnesota: West Publishing House Co.; Seidl-Hohenveldern Ignaz, International Economic Law, (1989), Dordrecht: Martinus Nijhoff Publishers.

³See General Assembly Resolution 3201 (S-VIII) of May 1st, 1974, reproduced in 13 International Legal Materials, (1974), at p. 715; 68 A.J.I.L., (1974), 798 - 808.

⁴General Assembly Resolution 3202 of May 1st, 1974, reproduced in 13 I.L.M., (1974), 720.

⁵General Assembly Resolution 3281 (XXIX) of December, 12th, 1974, reproduced in 14 I.L.M., (1974), 251.

⁶According to Robin C. White, in 'A New International Economic Order' 24 I.C.L.Q., [1975] 542, at p. 551.

⁷White *ibid.* at p.552; But see also the view of Milan Bulajic, 'Legal Aspects of a New International Economic Order' in Hossain *supra* n. 1 at p. 45 where he says that it is not a matter of codification and progressive development of abstract principles and norms of the NIEO, but incorporating and harmonising current international negotiations with the basic conception of the NIEO; See further Falk A. Richard et al., The United Nations and the Just Order, (1991), Boulder: Westview Press, in particular section 5 on 'The United Nations and World Economy' pp. 281 - 343.

'Current events have brought into sharp focus the realisation that the interests of developed countries and those of developing countries can no longer be isolated from each other, that there is a close interrelationship between the prosperity of the developed world and the growth and development of developing countries, and that the prosperity of the international community as a whole depends upon the prosperity of its constituent parts. International co-operation for development is a shared goal and common duty of all countries'⁸.

The documents on the NIEO also attempt to provide a wider framework for the regulation of cross-national corporations. In particular, these documents emphasise the need for host countries to regulate the activities of TNCs. For example, para 4(g) of the NIEO Declaration gives emphasis on:

'[The] Regulation and supervision of the activities of transnational corporations by taking measures in the interest of national economies of countries where such transnationals operate on the basis of full sovereignty of those countries'⁹.

That provision is fully supported by the Programme of Action which devotes a whole part¹⁰ on the *Regulation and Control over the activities of Transnational Corporations*. Also Article 2(2)(b) of the Charter of Economic Rights and Duties of States provides that "Every State has the Right:

To regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its national laws, rules and regulations and conform with its economic and social policies. Transnational corporations shall not intervene in the internal affairs of a host State. Every State should, with full regard of its sovereign rights, cooperate with other States in the exercise of the right set forth in this subparagraph'¹¹.

Despite the good intentions of these documents, their insistence on empowering national governments to regulate the activities of cross-national business activities has been received with scepticism. One commentator observes that the NIEO and therefore the proposed regulation on TNCs by nation States indicates that States are suffering from inferiority complex *vis-à-vis* TNCs¹². He goes on to observe that:

'It is... a false assumption to seek to organise controls [to TNCs] through UN, which was founded in order to safeguard the sovereignty of member countries....It is quite likely therefore, that the UN will not be able to close those loopholes through which multinationals can achieve incommensurate profits and advantages, and through which they also sometimes suffer losses...'¹³.

Other commentators take a more pragmatic view. They argue that what the UN did by passing the

⁸Supra n. 3, paragraph 3, at p. 716.

⁹Ibid. at p. 717.

¹⁰Part V of 13 I.L.M. (1974) 720 at p. 728.

¹¹Supra n. 4 at p. 255. For the proposed (but rejected) amendment to art. 2 see p. 262.

¹²See Rainer Hellmain, 'The Multinational Enterprise, The National State and Regional Groupings', in Curson Gerard and Curson Victoria, (Eds.), The Multinational Enterprise in a Hostile World, (1977), London: Macmillan at p. 121.

¹³Ibid. at p. 121.

resolutions which led to the NIEO, was something a little more (or less) than maintaining the *status quo*. At the end of the day what occurred was not the shift from confrontation to co-operation or conciliation, but conciliation without reconciliation of the basic and fundamental principles of states as embodied in the 'old' order¹⁴. In other words, "the principles of the NIEO expose the fiction of sovereign equality while continuing to assert it"¹⁵.

Such criticism is, to some extent, exaggerated. It must be accepted that, given the complexities of world business cultures and customs, changes cannot take place overnight. It is equally important to understand how far these changes should go. An analysis of different UNCTAD reports reveals that major steps towards pragmatic co-operation are already taking place¹⁶. In this sense pragmatic co-operation should not mean the total elimination of national laws aimed at regulating cross-national corporations. On the contrary, it may mean a careful and elaborate extension of some international rules in a framework of economic interdependence and co-operation. Thus, if new rules were to confer rights for the benefit of developing countries, and impose duties on developed countries (TNCs), these duties would be accepted only if corresponding duties were accepted by those who claim rights¹⁷. This is a real challenge facing the world community. Blumberg says that the answer to this challenge should involve:

'... the evolution over the years ahead of an international legal machinery to indicate, adjust and reduce national conflicts and emerge with a framework that will not only facilitate the imposition of effective governmental controls over the activities of Multinational groups, but [also] will encourage the harmonious development of international economic relations'¹⁸.

It is against this background that specific UN documents which aim at regulating the activities of cross-national corporations will be analysed. These documents include Codes of Conduct for

¹⁴Catherine B. Gwin, 'The Seventh Special Session: Towards a New Phase of Relations between Developed and Developing Nations', in Sauvant Karl and Hansenpling Hojo, (Eds.), The International Economic Order: Confrontation or Co-operation between South and North?, (1977), London: Wilton House Publications, p. 103, at p. 114.

¹⁵Chinkin C. M, 'The Challenge of Soft Law', 38 ICLO, (1989), 850, at p. 855.

¹⁶See different UNCTAD Reports since 1964, especially the UNCTAD Report TD/B/628/Add. 1, of 8 Oct. 1976, (Annex IV), at p. 3 the Secretary General notes that: 'The consensus which already has been reached on the broad goals and principles of the new international economic order does not preclude difficulties when it comes to elaborating practical policies and negotiating clear commitments....There are likely to be phases of tensions and disputes leading periods of compromise and co-operation. When it is well understood that this is to be expected it becomes possible... to direct the negotiating in constructive channels'. ; See also UNCTAD, TD/B/712, of 18th August, 1978 on 'Long-term Problems of Interdependence and the current World Economic Situation'; See also the Report by Michael Kaser to UNCTAD on, 'Trends in Trade and Economic Co-operation Among Countries Having Different Economic and Social Systems', UNCTAD/ST/TSC/9 of Nov. 1987; See also Branislav Gosovic, UNCTAD: Conflict and Compromise, (1971), Layden: A.W. Sijhoff.

¹⁷Norbert Horn, 'Normative Problems of the New International Economic Order', 16 J.W.T.L., (1982), 338, at p. 344.

¹⁸Blumberg Phillip, The Multinational Challenge to Corporation Law, (1993), Oxford: Oxford University Press, at p. 201.

TNCs. However, it is important to make a brief analysis of other international efforts geared to the regulation of cross-border business relations.

5:2:2 The GATT and the Regulation of Transnational Joint Venture Corporations.

The General Agreement on Trade and Tariffs (GATT) is another International institution which has the potential of regulating the behaviour of transnational corporations in their joint venture relationships with companies from developing countries. However, if there have been attempts to regulate the behaviour of transnational corporations through the UN organs (especially through the UNCTAD), the GATT has been the instrument used by developed countries to oppose them. This is because since its inception the GATT was designed to guard and uphold the principles of free market economy and of non-intervention in the business activities of corporations at the international level. Thus, if the NIEO favoured developing countries, the GATT strengthened the position of developed countries against them.

The GATT is principally aimed at limiting the ability of a single state to impose tariffs and non-tariff barriers against the business enterprises of other states. This was effected thorough what is famously known as the most-favoured-nation clause (MFN)¹⁹. The initial agreement was not ideal for most developing countries who by then were busy building their domestic industrial potential which would have been destroyed if open to competition. However, even after some developing countries signed or joined the agreement, their concern was that it did not cover their agricultural products and that, given unequal levels of development, the MFN system benefited developed countries at the expense of developing countries. They therefore negotiated for terms which would afford them preferential treatment. Some of these negotiations were included in Part IV of the GATT agreement²⁰. However, these improvements have been criticised on the basis that they were agreed only because "they involved so little interference with the operation of market forces"²¹. In other words, they were not specifically aimed at helping developing countries' economic development. The general evaluation of the GATT as far as the establishment of the NIEO is concerned was given by the then Secretary General to the UNCTAD:

'GATT has not served the developing countries as it has served the developed countries. In short, GATT has not

¹⁹For more discussion about this see Dam Kenneth W., The GATT Law and International Organisations, (1970), Chicago: University of Chicago Press, pp. 18 - 19; Hudec Robert, E. Enforcing International Trade Law: The Evolution of the Modern GATT System, (1993), New Hampshire, Butterworth Legal Publishers, pp. 120 - 123; Stewart Terence, P. (Ed.) The GATT Uruguay Round: A Negotiating History (1986 - 1992), (1993), Deventer, Kluwer Law and Taxation Publishers.

²⁰See Basic Instruments and Selected Documents of GATT (BISD) 13 Supp. (1965), p.10; See also McMahon Joseph, A. Agricultural Trade, Protectionism and the Problems of Development, (1992), Leicester: Leicester University Press, pp. 24 - 31; Hudec *ibid.* pp. 228 - 229.

²¹*Ibid.* at p. 30.

helped to create the new order which must meet the needs of development, nor has it been able to fulfil the impossible task of restoring the old order²².

However, such a sceptical evaluation was made before the finalising of the Uruguay round negotiations. An analysis of the Ministerial Declaration which is the basis of these negotiations indicate that they aim at liberalising trade, stimulating investment in developing countries and harmonising the necessary trade safeguards²³. Although the benefits of these negotiations to joint venture companies in developing countries remains to be seen, they express (arguably for the first time) co-operative attempts between developing and developed countries to tackle the current world trade problems.

At the moment, it may be doubted whether GATT can assist in the determination or provision of the machinery for the regulation of TNCs in their joint venture relationships with companies from developing countries. This is because that would be contrary to its ideology of maintaining a free market economy. Thus, although the growth of interdependence among nations has necessitated business co-operation in forms of joint ventures, and all states have shown the will to maintain it, the international legal machinery which aims at co-operation rather than confrontation and mutual benefits rather than individualism is still lacking.

5:2:3 The EEC - ACP Dialogue.

In their search for machinery based on co-operation to regulate the activities of cross-national companies, the African Caribbean and Pacific (ACP) countries have tried to reduce the effects of the GATT through negotiations with their former 'colonial masters', who are now strong members of the European Economic Community (EEC). These negotiations have culminated in the Lome IV Convention²⁴ which has been referred to as the symbol of North - South co-operation²⁵.

The Convention has a general objective of providing a firm and solid foundation for trade co-operation between the ACP and EEC states, based on free access to the EEC markets for products originating in the ACP countries. As far as business enterprises (corporations) are concerned the Convention has some specific provisions, although they do not specifically deal with joint ventures.

²²"A New Trade Policy for Development', Proceedings of UNCTAD I, (1964), New York, UN, vol II, Statements, p. 6.

²³See the Declaration by Ministers meeting of the Special Session of CONTRACTING PARTIES at Punta del Este, on Multilateral Negotiations of 1986, reproduced in Stewart Terence, P. *supra* n. 19, pp. 1 - 64; See also Williams Mark, International Economic Organisations and the Third World, (1994), New York: Harvester, pp. 146 - 178, at pp. 148 - 150.

²⁴Reproduced in the Courier No. 120 of April, 1990; See also 29 I.L.M., (1990), pp. 783 - 901.

²⁵John Ravenhill, Collective Clientism: Rome Convention and the North - South Relations, (1985), Columbia: Columbia University Press, at p. 1; See also the Courier No. 134, of July - August, 1992, pp. 7 - 10.

Part Three of the Convention, under the title; "The Instruments of ACP - EEC Co-operation" recognises business enterprises as one of the instruments of trade co-operation. It requires co-operation between ACP and EEC countries to:

'promote the development of enterprises by taking such steps as are necessary to improve the business environment, and, in particular, foster a legal, administrative and incentive framework which is conducive to the emergence and development of dynamic private sector enterprises including grass roots operations'²⁶.

The above paragraph gives the impression that both the ACP and EEC countries will co-operate to develop a new legal framework conducive to the emergence and development of private enterprises. But the provisions which follow, especially Section 6 which specifically deals with the "Qualification and Treatment of Business Enterprises", may defeat the intention. This is because the section allows the states (both ACP and EEC) to treat nationals, companies and firms from other member countries on a non-discriminatory basis, based on host countries' respective national civil and company laws²⁷. Although it would be unfair to criticise the Article for being based on the assumption that national company laws can be non-discriminatory, the Article would have been more helpful to the ACP countries if it had provided the means to harmonise the company laws of both ACP and EEC countries so as to achieve non-discriminatory treatment. However, it is equally important to consider whether this harmonisation is what is referred to as 'helping the ACP countries to develop a legal framework for the achievement of a dynamic private enterprise'.

Despite some recorded success in the implementation of the Lome IV Convention²⁸, general concerns have been expressed about its negative effects. These include its potential for reducing the solidarity of developing countries²⁹ and the internal contradictions which indicate that it cannot be fully implemented. One aspect of the Treaty which has been effectively implemented is the provision of aid to ACP countries³⁰. But the Treaty has not resulted in the development of legal mechanisms to help them to create fair business enterprise structures to be the recipients of aid and the main actors in spearheading economic development. After few years of its operation complaints by the ACP leaders are mounting. For example, one of these leaders lamented that:

'in the real world, where we all have to gain our living, a trade preference is only a value where a trade exists. The sad and solemn fact is that for very many ACP countries, the preference accorded have little or no value, because a trade does not exist: or if it once did, it has now diminished'³¹.

²⁶29 I.L.M. (1990), art. 258 para (g) at p. 864.

²⁷Ibid. article 274, at p. 867.

²⁸Always reported at the last pages of every Courier .

²⁹McMahon supra n. 20, at p. 209.

³⁰However, the provision of development aid without assisting developing countries to establish grass root enterprises or fair joint ventures with TNCs may not help their economic development. See Howard White, 'Is Development Aid Harmful to Development?', the Courier No. 137, of Jan - Feb. 1993; See also Marie - Angeline Save, 'Development Aid in 1990s', the Courier No 137, loc cit., at p. 93.

³¹In a Symposium, 'Trade Issues in the Context of Lome IV and 1992', reported in the Courier No. 123 of Sept

Trade has diminished in ACP countries because:

'the ACP states [are] not creating right conditions for profit and ACP financial transfers [are] always being made to the benefit of the developed world'³².

When the above facts are considered, "one is left with the impression that the EEC is pursuing old policies with new means"³³. It has been suggested that what is needed as a solution is "a wholesale revision of the instruments of co-operation"³⁴. This revision may bring to light the inadequacies in the regulation of joint venture business enterprises as important instruments for co-operation. While this is being pursued developing countries are once again left at the cross-roads. Should they vigorously pursue negotiations towards the completion of 'International Company Law', particularly through the Codes of Conduct to TNCs, or develop a 'Regional Company Law', based on regional co-operation? Might they pursue both options? We shall analyse these possibilities below.

5:3. WORLD COMPANY LAW.

As early as 1944 Professor Schmitthoff had already made a case for the registration of International companies (TNCs) at the International Court of Justice at the Hague³⁵. Perhaps this might have been possible *de jure*, but *de facto* the economic relations pertaining at that time were not conducive to such a legal requirement. His suggestions are nevertheless becoming more realistic both *de jure* and *de facto* during this decade and may occupy the activities of the international economic lawyers of the 21st century. This decade has witnessed many cross-national business relations between companies. Relationship forms such as joint ventures which

- Oct, 1990, pp.6 -7, at p.7

³²Ibid. at p. 7.

³³Frey-Wouters, The European Community and the Third World, (1980), New York: Praeger, at p. 253.

³⁴McMahon, supra n. 20 at p. 202.

³⁵Noted by Tindall Robert Emmett, Multinational Enterprises: Legal and Management Structures and Control Interrelationships with Ownership, Control, Antitrust, Labour, Taxation and Disclosure, (1975), New York: Oceana Publications Inc. at p. 130; The Original proposal appeared in Schmitthoff Clive, M. 'The International Corporation: Legal Organisation of Planned World Economy', in vol. 30 Transactions of Grotius Society, (1944), London, pp. 165 - 183. It is also reproduced in Cheng Chia - Jui (Ed.), Clive M. Schmitthoff Selected Essays on International Trade Law, (1988), Dordrecht: Martinus Nijhoff, pp. 694 - 707; See also Vagts Detlev, F. 'The Multinational Enterprise: A New Challenge for Transnational Law' 83 Harv.L.Rev., (1970), 739, at pp. 787 - 789; Rubin, 'Corporations and Society: The Remedy of Federal and International Corporation', 23 Am.U.L.Rev. (1973), 263; According to UN World Investment Report, (1993), supra n. 1, at p. 189 the lack of interests to the idea of establishing an international company law comes from the perception that the idea is impractical: it would be hard to draft such a statute, it would be unlikely that all major states would agree to be bound by it and TNCs themselves have consistently being opposed to it. However, the report says that such a statute has also advantages, in particular, the fact that such a law would deal with the TNC as a whole, filling the gap of legal regulation at the international level.

go beyond the regulatory framework of a single state and need the co-operation of different states are a typical mechanism for modern foreign direct investment (FDI).

The term 'world company law' is nothing more than an expression indicating the need for having a common regulatory framework based on co-operation, to regulate the behaviour of TNCs in their business relationships with host countries³⁶. This framework is necessary to reconcile the consequences of the open-door and free market policies, currently being pursued by host countries, with the concept of the equal sovereignty of states which empowers every state to control and manage its economic development. The effort of creating a co-ordinated regulatory framework for TNCs began with the idea of 'a code of good conduct' for TNCs.

5:3:1. THE UN CODES OF CONDUCT FOR TRANSNATIONAL CORPORATIONS.

The Programme of Action on the Establishment of the International Economic Order emphasises *inter alia* that, "all efforts should be made to implement an international code of conduct for transnational corporations", in order, *inter alia*, to regulate their activities in host countries and bring assistance, transfer of technology and management skills to developing countries, on equitable and favourable terms³⁷.

Although the Programme of Action shows clearly what the objectives of the Code should be, we now witness divided and mostly uncoordinated efforts. The first division is as it were, between developed and developing countries. This division has resulted in two competing and contradictory approaches. More developed countries have focused on the establishment of the rules within the Codes which guarantee free but fair competition among TNCs and which harmonise or unify national policies towards TNCs. To the contrary, developing countries are pushing for mandatory rules or constraints on TNCs, including mandatory local ownership and control³⁸. However, a solution which is based on co-operation may be found in neither of the two extremes, but between them.

Fear and disagreement about the legal enforcement of the Code(s) has created another major division. Instead of embarking on drafting, adopting and implementing a more comprehensive Code, the codes have been drafted on a piecemeal basis. As a result we now see a series of

³⁶Kahn Philippe, 'International Companies', Business Journal of World Trade Law, (1969), 498, at pp. 500 - 508 he attempts to define the international company.

³⁷Part V of the Resolution, *supra* n. 4, p. 728.

³⁸Gross Robert, 'Codes of Conduct for Multinational Enterprises' 16 Journal of World Trade Law, (1982), 414, at p. 415; See also different articles in Horn Norbert (Ed.), Legal Problems of Codes of Conduct for Multinational Enterprises, (1980), Antwerp: Kluwer; See also Vagts Detlev F., 'Multinational Corporations and International Guidelines', 18 Common Market Law Review, (1981), 463.

different Codes of conduct, which are, to a great extent, uncoordinated³⁹.

Apparently, the decision on the legality of these codes has overshadowed the analysis on their substance. The main issues which remain to be analysed are: whether it is appropriate to have many codes dealing with the same main issue, namely the regulation of the relationship between transnational corporations and states (both home and host); and, whether, when the codes are considered together they are able to streamline this relationship. The second issue will be the main concern of this part.

A. The Tripartite Declaration on Principles concerning Multinational Enterprises and Social Policy.

This declaration was drafted and adopted under the auspices of the International Labour Organisation of the UN. The aim of the declaration is to encourage the positive contribution which multinational corporations can make to the economic and social development and to minimise or resolve difficulties to which their various operations may give rise, taking into account of the UN resolution advocating the establishment of the NIEO⁴⁰.

This declaration requires TNCs when operating in developing countries to endeavour to increase employment opportunities and standards by giving priority to the employment, occupational development, promotion and advancement of nationals of host governments at all levels⁴¹.

As regards the representation of employees in the decision making of the TNCs' affiliates in the host countries the declaration provides that:

'Where appropriate, in the local circumstances, Multinational Enterprises should support representative employees organisations'⁴².

and that:

"Multinational Enterprises should enable duly authorised unions of the workers in their employment in each of the countries in which they operate to conduct negotiations with representatives of the management who are authorised to take decisions on matters under negotiation"⁴³.

It is submitted that the declaration avoids the issue of workers participation in the decision

³⁹As discussed *infra* pp 180 - 192.; Generally see Asante Samuel, K.B., 'International Law and Foreign Investment: A Reappraisal', 37 I.C.L.Q., (1988), 588.

⁴⁰See Article 2 of the Declaration, reproduced in 17 I. L. M., (1978), p.424.

⁴¹*Ibid.* art. 18.

⁴²*Ibid.* art. 43.

⁴³*Ibid.* art. 51.

making of TNCs which, arguably, should have been a major concern of the code. It relegates the issue of workers representation to the national laws of different countries in which affiliates of TNCs are established⁴⁴. National laws may not affect the decision of TNCs in cases where the affiliates are under direct or indirect control of the parent corporations of TNCs established in the home countries. Although Sauvart and Liner⁴⁵ propose a national solution, the problems remain global. Hence, the need for a certain degree of co-operation to resolve them.

Because it does not attempt to provide such a solution, the declaration does not provide mechanisms through which employees of affiliates who are adversely affected by the decisions of the central management of a TNC can win redress for their loss. Arguably, this is why the Bhopal victims in India could not use the declaration as the basis of their claim for damages from the Union Carbide Corporation which is an American Corporation⁴⁶.

The issue of employee participation in the decision making of TNCs is complex and will remain so unless co-operative efforts to solve it are sought through the introduction of the concept of groups of companies and enterprise law, at the international level.

B. The Code of Conduct for the Transfer of Technology.

The proposed draft of the code was tabled before the UNCTAD's third session of 6 May 1980⁴⁷. Basically, the code is designed to be general in nature. It applies to any person whether natural or juridical and includes incorporated branches, subsidiaries and joint ventures, or other legal entities, regardless of the economic and other relationships between and among them⁴⁸. Thus, it is not specifically directed to transnational corporations as whole enterprises. Indeed, it regulates the technological flow between different affiliates of a TNC, with parent companies mostly regarded as supplying companies⁴⁹.

Although the code comprises a litany of obligations of supplying companies and rights of

⁴⁴See Gunter Hans, 'The Tripartite Declaration of Principles (ILO): Standards and Follow-ups', in Horn *supra* n. 38, p. 155, at pp. 162 - 165.

⁴⁵See Sauvart Karl, P. and Lanier Elton, R., 'Host Country Councils: Concepts and Legal Aspects', in Horn *supra* n. 38, p. 341.

⁴⁶See Blumberg Phillip *supra* n. 18 at pp. 189 - 190; Compare with the Badger Case where the workers of Badger-Belgium got compensation from Badger-USA, basing on the OECD Code of Conduct, Blumberg *loc. cit* pp. 190 - 195; See further, Trotter, R, Susan Day and Amey E, 'India and Union Carbide: The Second Tragedy', 8 *Journal of Business Ethics*, (1989), 439 - 454, they say that the Union Carbide Corporation preferred out of court settlement rather than involving itself to unspecific legal procedures.

⁴⁷Reproduced in 19 *I.L.M* (1980), p. 773.

⁴⁸See Chapter 1.1(a) of the draft *ibid.* at p. 775.

⁴⁹*Ibid.* 1.1(b) and (c).

acquiring companies, it also reveals some remarkable weaknesses.

Firstly, its general nature makes its specific application to a TNC difficult. This is because it takes for granted that subsidiaries of TNCs are independent acquiring parties. Whereas, in practice, as part of the internal arrangements of a TNC, most of the technology transferred to subsidiaries or to controlled joint ventures is, to some extent, imposed on them by their parents. Although this may be seen as a normal global business arrangement of the TNC as a whole, it may have adverse effect to the host country in which the technology is used⁵⁰.

Secondly, the above problem becomes severe when there are no international standards to protect the host country or its nationals who may be affected by the transferred technology. The code leaves the protection of the acquiring party under the laws of the host country⁵¹. The laws of a single nation may not be able to regulate the 'supplier' of technology in more complex transactions. The fact that the acquiring party or its nation does not have the technology should be sufficient to indicate that it needs international co-operation in ascertaining the value of the technology to be acquired.

C. The General Code of Conduct for Transnational Corporations.

The Code has been in its draft stage for more than two decades, although it has been 'updated' from time to time⁵². A cynic may argue that it will never be operative, since most of what it is to contain forms part of other codes of conduct, some of which we have just discussed. However, it is equally true that the remaining issues and provisions tend to be the most sensitive ones and are the centre of conflict and negotiation between the different parties concerned.

According to the 1988 draft⁵³, the code will have two main sections: one on the regulation of the behaviour of transnational corporations, and the other, on the governments. We shall discuss them *seriatim*.

I. Regulations on Transnational Corporations.

⁵⁰See Thomson Dennis, 'The UNCTAD Code on Transfer of Technology', 16 Journal of World Trade Law, (1982), 311 - 337 at pp. 335 - 337; Syquia Engerique, 'Technology and Restrictive Business Practises: The Viewpoint of Developing Countries', in Horn supra n. 38, p. 211; Wilner Gabriel, M. 'Transfer of Technology: The UNCTAD Code of Conduct', in Horn loc cit., p. 177, at p. 188.

⁵¹See Ch. 3 of the Code supra n. 47, pp. 779 - 781.

⁵²Our research was based on the 1988 draft, presented by UN Secretary General at the UNESCO in 1988, E/1988/39/Add. 1, 1st Feb. 1988, reproduced in, Simmonds Kenneth, R., Multinational Corporation Law, (binder marked **), (1992), London: Oceana Publications.

⁵³Ibid.

The first articles of the Code emphasise the sovereign rights of nations. They require TNCs to refrain from improper interference in the internal affairs of host countries, and, to respect host countries' cultural and social objectives⁵⁴. The code then turns to the economic and financial aspects of the activities of TNCs in host countries. In particular, it provides for regulation in: ownership and control, balance of payments, transfer pricing, taxation, transfer of technology, and consumer and environmental protection⁵⁵. According to Asante⁵⁶ these are the areas which have generated perennial conflicts between host governments and TNCs. For the interest of our research we shall discuss further the issue of ownership and control.

(i) Ownership and Control.

It is now internationally accepted that control is not limited to share-ownership, it also includes substantial influence over the activities of affiliates⁵⁷. It has been argued further that the cardinal objective of ownership and control provisions in the code is to direct TNCs to contribute to the social and economic development of the countries in which they operate⁵⁸. The provisions on ownership and control address mainly three issues: (a) the distribution of responsibilities among the entities of a TNC so as to enable each of them to carry out effectively its dual obligation of making profits for the TNC as a whole, and of contributing to local national development; (b) Joint equity or non-equity participation between TNCs and local governments or nationals; and, (c) the requirement that TNCs train local managerial and technical personnel.

(a) Transnational corporations are required by the code to distribute their ownership and control among their different entities so that they not only contribute to their own profits, but also to the economic development of the countries in which they operate. According to article 22 of the draft:

'Transnational corporations should make every effort so to allocate their decision-making powers among their entities as to enable them to contribute to the economic and social development of the countries in which they operate'⁵⁹.

An analysis of this provision reveals that the solution which this article intends to provide, namely making TNC's entities fulfil their dual obligation of paying allegiance to both the TNC and the

⁵⁴See Part A, paras. 7 - 21 of the Code *ibid*.

⁵⁵See Part B of the Code, paras. 22 - 45 *ibid*.

⁵⁶*Supra* n. 39 at p. 621.

⁵⁷See Bondzi-Simpson Ebow, P. Legal Relationships Between Transnational Corporations and Host States, (1990), New York: Quorum Books, at p. 134.

⁵⁸*Ibid.* at pp. 134 - 135.

⁵⁹*Supra* n. 52.

host government, may not be adequate. This is because the root of the problem is deeper than is outwardly seen. It centres on making the affiliates of TNCs both legally and economically independent. When affiliates of TNCs are dependent on their parent companies it may be difficult for them to contribute to the economic development of the countries in which they operate. The provision should have emphasised the importance of establishing TNC affiliates which are economically and legally independent of the parents (i.e., which operate as enterprises). Also liability could have been established on TNCs for the losses their affiliates suffer because of TNCs control. In other words, the concept of groups of companies discussed in the third chapter would have been extended to apply to TNC groups.

(b) Another issue which is dealt with under ownership and control is the aspect of joint equity or non-equity participation between TNCs and local nationals in entities which TNCs establish in host countries. This is introduced to reduce the concentration of ownership and therefore control in the hands of TNCs⁶⁰. The requirement aims to promote co-operative business organisations such as joint venture companies between TNCs and local companies. We have argued elsewhere in this study that joint equity ownership which is the criterion for the establishment of joint venture companies in most developing countries may not be sufficient to indicate joint control or even joint ownership in a general sense⁶¹. Fortunately, the draft also recognises non-equity participation as another source of control. However, the general character of the draft on this respect leaves some issues unaddressed.

First, it seems that this provision was introduced to satisfy the demands of developing countries who saw the establishment of wholly-owned subsidiaries by TNCs as weakening their power of control and therefore their chance of receiving a share in the profits generated by TNCs in their countries. In this sense the joint venture is seen as an end in itself, rather than being the means of achieving profits which could be equally achieved by wholly-owned subsidiaries, if they were economically independent, or if proper regulations were introduced to make TNCs pay for their dependent subsidiaries. We have argued elsewhere in this study that the concept of the joint venture implies interdependence, and is highly dependent on whether the participating parties have complementary inputs and objectives⁶². The provision for joint equity or non-equity participation should have emphasised this precondition.

⁶⁰According to Paragraph 24 of the Code *ibid*: 'Transnational Corporations should co-operate with governments and nationals of the countries in which they operate in the implementation of national objectives for local equity participation and for the effective exercise of control by local partners...'; See further Vagts *supra* n. 35 at pp. 783 - 785.

⁶¹We have argued in chapter four *supra* that the general sense of ownership and control should include the ownership and therefore the control of managerial skills and technical know-how which are invested by TNCs in joint venture companies formed in developing countries to generate profits, see pp. 105 - 145.

⁶²See our discussion in chapter two *supra* pp. 28 - 31.

Second, even after the formation of a joint venture based on complementary inputs, further provisions are needed to ensure that interdependence does not result in dependence through the *ex-post* execution of the joint venture's activities. Several factors are omitted from the Code which would point in that direction. For example, joint control may be jeopardised if the constitution of the joint venture company is drafted in a manner indicating that one party should control the operations of the venture and thus be vested with exclusive power to provide management and technology. Equally if one party is given an exclusive power or a right of veto over important decisions of the venture or over appointments to strategic offices joint control may be reduced⁶³. There should be internationally recognised rules or principles to ensure that these powers are not abused and when they are, liability should be imposed on those who abuse them⁶⁴.

(c) In recognition of the fact that it is always the TNC which is given the exclusive power to manage the activities of the affiliates they establish jointly with developing countries, an obligation is imposed on TNCs when developing their personnel policies to give priority to employees from the countries in which they operate. This includes offering managerial and technical training to these employees⁶⁵. This sounds like a good idea, especially when one considers provisions for training of local personnel in management and technical services agreements in Tanzania discussed in the next chapter⁶⁶. However, it is important to consider how the TNC may utilise and organise these employees. This is because after they have been integrated in the centralised employment mechanism of the TNC (assuming that the subsidiaries that they are working for are dependent on the parent company of the TNC) they will definitely get orders from the centre. Emphasis should have been put on the requirement that the locally recruited employees should be as independent as possible in their decisions. In this sense, they should not also favour the partners from their countries. Again, given the non-availability of qualified local managers or technicians, and thanks to the provisions which gives emphasis on their training, it could have been more helpful if this provision would have gone further to provide for the systematic phasing out of TNCs' employees when local labour markets are able to provide such services.

⁶³See further our discussion in chapter four *supra* pp. 90 - 104.

⁶⁴In chapter four *supra* we noted the development of the concept of fiduciary duty to cover dominant shareholders or shadow directors. Also we saw that in some instances the veil of incorporation of affiliates may be lifted to attack parent companies. All these steps may safely be grouped under the concept of groups of companies as discussed in chapter three, and in order to apply this concept to TNCs co-operative efforts of the international community are needed so that the concept of groups of companies can be extended to companies which operate across national boundaries. See generally Blumberg *supra* n. 18 pp. 90 - 96; See also UN, World International Report: Transnational Corporations and Integrated International Production, (1993) New York: United Nations Press, pp. 196 - 201.

⁶⁵See paras. 25 and 26 of the Code *supra* n. 52.

⁶⁶See chapter six *infra* pp. 238 - 242.

Therefore, the issue of ownership and control needs further input if it is to apply to all Transnational business organisations, including cross-national joint ventures. To be sure, if ownership and control problems are solved other problems such as taxation, transfer pricing, balance of payments, etc., may be easily resolved. However, this depends on whether the required information on the TNC as a whole is readily available to both host and home countries.

(ii) Disclosure.

The issue of disclosure is dealt with in Part C of the Draft⁶⁷. According to paragraph 46:

'Transnational corporation should disclose to the public in the countries in which they operate, by appropriate means of communication, clear, full and comprehensive information on the activities and operation of the transnational corporation *as a whole*. The information should include financial as well as non-financial items and should be made available on a regular annual basis, normally within six months from the end of financial year and in any case not later than 12 months from the end of the financial year of the corporation....' (my own emphasis).

The paragraph goes on to provide for the kind of information to be disclosed. This includes: a balance sheet, an income statement, a statement of the sources and uses of funds, allocation of net profits, new long-term capital investment and, R&D expenditure⁶⁸. The paragraph also requires mandatory disclosure of non-financial matters such as: the structure of the TNC, names and allocation of the parent companies, its main entities, the main activities of these entities, employment information, and, policies applied in respect of transfer pricing. Paragraph 47 also requires TNCs to supply to host countries in which they operate with all necessary information for purposes of local legal and administrative matters.

The legal duty of disclosure to corporations cannot be overemphasised. It is through the disclosure of relevant information that national authorities are able to make fair assessments of business transactions within their countries for purposes of economic planning, taxation, etc. However, disclosure becomes more difficult and complex when it applies to TNCs. Legally speaking, currently TNCs as such are under no international legal obligation of disclosure. The duty of disclosure in different countries only affects the fragments of TNCs, not the TNC as a whole. This situation gives great deal of room to TNCs to manipulate their affairs across different countries and thus cause problems of transfer pricing, tax avoidance, balance of payments distortion, etc.,. The problem of disclosure by TNCs is now global. It affects both developed and developing countries⁶⁹. However, developing countries have not yet gone so far as to require

⁶⁷Ibid. paras. 46 - 48.

⁶⁸Paragraph 46 *ibid*.

⁶⁹To the developed countries like those of the EEC the requirement for disclosure has been extended to transnational groups of companies. This is according to the 7th EEC Company Law Directive, discussed *infra*

TNCs to disclose information as whole enterprises, as is a case in some developed countries⁷⁰. The fact that the Code is not yet in force prompts the suggestion that developing countries should consider amending their laws to require TNCs to disclose information as whole enterprises. However, since this is not a co-operative solution, unharmonised rules of disclosure are likely to escalate conflicts rather than solving them.

Transnational corporations' concern on the issue of disclosure centres on the confidentiality of the disclosed information. Confidentiality is very important to TNCs to enable them maintain their competitive edge *vis-à-vis* other TNCs. In order to assure TNCs of confidentiality, paragraph 54 would establish a duty on host countries to accord reasonable safeguards to the information provided by TNCs. This introduces us to the second part of the code, namely national obligations.

II. Treatment of Transnational Corporations by Host Countries.

Host countries, especially those from developing countries reject the idea of establishing any legal obligation on their part towards TNCs, because it would endanger their sovereignty⁷¹. But it seems inevitable that for the code to be acceptable to both developed and developing countries, it should provide some protection to TNCs against arbitrary acts of host countries. In most cases safeguards are required in two areas: the general national treatment of TNCs, and nationalisation and compensation.

(a) National Treatment.

The national treatment clause was borrowed from the OECD Code of conduct on TNCs⁷². Like its variant, the MFN clause of the GATT⁷³, the clause is included in the code to prevent discriminatory treatment between local enterprises and entities of TNCs. It provides that:

pp 198; On American TNCs Disclosure see Blumberg supra n. 18, pp. 180 - 201. But if the requirements for disclosure are not co-ordinated with those which are imposed on the affiliates of TNCs in developing countries, discriminatory disclosure may result into unfair or discriminatory treatment of some TNCs. According to Vagts, supra n. 35, at p. 789, footnote 207: 'If an MNE must report its income on the same basis to all agencies in each country, it will not be able to shift income artificially to avoid taxation'.

⁷⁰For example, this requirement is lacking in the Company Laws of Tanzania, see sections 320A - 322 of the Tanzanian Companies Ordinance.

⁷¹See generally, Kelly Elsa, 'National Treatment' and the Formulation of Code of Conduct for Transnational Corporations', in Hossain (Ed) supra n.1, p. 137; Compare with the views of Bondzi-Simpson Ebou, 'Transnational Corporations in Africa: A Framework for Regional Regulatory Arrangements', in Bondzi-Simpson Ebou (Ed.), The Law and Economic Development in the Third World, (1992), New York: Praeger, p. 83, at p. 91, he argues that the claim for national treatment of all locally incorporated firms has substantial merit.

⁷²See Guideline II.1 of the Code, reproduced in 15 I.L.M., (1976), pp. 961 - 977. at p. 968.

⁷³See our discussion supra pp. 175 - 176.

'Subject to the national requirements for maintaining order and protecting national security, and consistent with national constitutions and laws, and without prejudice to the measures in legislation relating to the declared objectives of developing countries, entities of transnational corporations should be given treatment accorded to domestic enterprises in similar circumstances...'⁷⁴.

This clause has been the centre of conflict between developing countries and developed countries. While developed countries want the clause to be part of the code, developing countries do not⁷⁵. Ironically, many of the developed countries who are members of the OECD have been reported as failing to obey the equivalent clause in the OECD code⁷⁶. Nevertheless, the basis of the conflict between developed and developing countries must be understood. Host countries have always been suspicious of TNCs because they are not able to control their supranational operations. While local enterprises are treated as whole enterprises, similar treatment if accorded to only one fragment of the TNC may in fact disadvantage the host country. Bearing in mind that TNCs are able to manipulate the financial structures of their entities at the expenses of host countries, the latter countries feel justified in treating them differently. Unless TNCs are treated as whole enterprises, this clause will continue to look unfair, and discriminatory treatment will continue, not only in developing countries, but also in developed ones.

(b) Nationalisation and Compensation.

There is a subtle contradiction between the concepts of nationalisation and that of national treatment of entities of TNCs. This is because, those who argue for the inclusion of the national treatment clause in the code use the legal argument that by virtue of incorporation affiliates of TNCs are national companies of the countries in which they are incorporated⁷⁷. Conversely, the nationality of companies and therefore the ability of nations to regulate the allocation of their assets is not recognised when it comes to nationalisation.

As we have seen elsewhere, incorporation theories have always been a fiction. Therefore, they cannot apply to real situations of which nationalisation is a part. Nationalisation means the expropriation of *the assets of TNCs* operating in a given country or territory. It does not matter whether these assets belong to a subsidiary, branch or a joint venture company, provided it is under the control of the TNC. In the latter sense therefore, nationalisation may be total or partial.

⁷⁴Para. 52 of the Code supra n. 52.

⁷⁵See Kelly supra n. 71, at pp. 148 - 155.

⁷⁶Wallace Day Cynthia, Legal Control of Multinational Enterprises, (1982), The Hague: Martinus Nijhoff Publisher, at pp. 55 - 67 she mentions Canada, France and Japan among the countries which have been breaching this clause; See also the 1979 OECD report on the implementation of 1976 declarations, reproduced in 18 I.L.M., (1979), p 986, at pp. 993 - 995.

⁷⁷See for example Bondzi-Simpson supra n. 71, at p. 91, He argues *inter alia* that: 'The right of national treatment attaches to the locus of incorporation of firms rather than to the nationality of the controlling shareholder'.

In a partial nationalisation joint ventures may be formed. In this sense, nationalisation and indigenisation do not differ much⁷⁸.

The concept of nationalisation stems from the well established principle of international law of state sovereignty, which accords exclusive right to nations, to own, control and dispose of their natural resources and business activities within their boundaries. Developing countries have repeatedly claimed the exclusive exercise of this right. However, as the code shows, a consensus, which is based on a more realistic approach, has already been reached. Nationalisation is to be exercised only in the public interest and whenever it is exercised, appropriate compensation should be paid⁷⁹.

The Problems of the Codes of Conduct.

The above analysis on the codes of conduct for TNCs shows that there is a growing consensus that national controls to TNCs by themselves, unaided by some international mechanism, are inadequate to deal with the global strategy of TNCs⁸⁰. However, the shape of any international regulation to TNCs is not yet settled. Although TNCs are a phenomenon of the 20th century, they have, unlike domestic companies, enjoyed the benefits of the traditional *laissez-faire* liberal Western business principles, based on Adam Smith's theories of free enterprise and free competition⁸¹. The traditional customary international law only ensures protection of TNCs in foreign countries by obliging host countries to honour their transactions with TNCs, under the principle of *pacta sunt servanda*⁸². With the growth in interdependence and co-operative business activities which lead to the internationalisation of business relationships, the regulation of TNCs has become a matter of global concern. However, the first international effort in this direction, namely the codes of conduct may not solve the problem.

⁷⁸See our discussion in chapter two supra pp. 18 - 21, on 'forced joint ventures'.

⁷⁹However, some disputes still exists on what amounts to an international transaction and appropriate compensation. Developed countries would like the word "appropriate" to be substituted with "fully", "adequate" or "prompt", see Bondzi-Simson supra n. 71 pp. 93 - 94; See s. 57 of the Code supra n. 52.

⁸⁰See Asante supra n. 39, p. 589.

⁸¹According to Gross supra n. 38, at p. 416 the theories of Adam Smith are increasingly becoming archaic. He goes on to say that: 'Adam Smith would recognise the vast difference between his concept of free market, with numerous small competitive firms, and the present reality in many industries with a few huge oligopolistic firms that compete often on non-price grounds'.

⁸²Asante supra n. 39, at p. 590; See also Horn Norbert, 'Codes of Conduct for MNEs and the Transnational *Lex Mercatoria*: An Introduction Process of Learning and Law Making', in Horn Supra n. 38, p. 45, at pp. 59 - 60; Lillich Richard, B. (Ed.), *International Law of States Responsibility for Injuries to Aliens*, (1983), Charlottesville: University Press of Virginia, especially an article by Fatouros A. A, 'Transnational Enterprises in the Law of State Responsibility', at p. 361; But see also the *Barcelona Traction* Case, reported in (1970) I.C.J, Judgement, 5, pp. 4ff.

Those who argue in favour of codes of conduct are of the view that the codes should concentrate only on international issues between TNCs and domestic companies. Hence, the current characteristic of the codes which emphasises the enhancement of national control of the activities of TNCs is in itself a problem. If national legislation itself is unable to regulate the activities of TNCs, within national boundaries, emphasis on doing so by international codes may be mere rhetorics which will not change the *status quo*. Thus, the supporters of the codes argue as follows.

First, that the codes should act as international standards for public policy⁸³. They should largely neutralise the effect of lack of international legal personality.

Second, that codes which are adopted in a largely binding form would impose on a state party legal duties calculated to enhance national control over TNCs⁸⁴.

Third, that Codes have a legitimising effect, in the sense that they may be a source of reference for national and international legal developments. For example, they may be used by employees' unions in bargaining with the TNC as a whole⁸⁵.

Fourth, Codes also have an educational function. The process of their formulation stimulates constructive and academic debates which add to the understanding of transnational business relations⁸⁶.

Fifth, Codes can act as models for national or regional measures to control transnational business transactions⁸⁷.

Six, Codes act as standards and data in aid of the interpretation and application of prior agreements and treaties to current situations of transnational business relations⁸⁸.

⁸³See for example, Baade Hans, W. 'The Legal Effects of Codes of Conduct for Multinational Enterprises', in Horn *supra* n. 38 p. 9 at pp. 29 - 31; See also Bondzi-Simpson *supra* n.57 at p. 58.

⁸⁴Fatouros, 'The UN Code of Conduct of Transnational Corporations: Problems of Interpretation and Implementation', in Rubin Seymour, J. and Hufbauer Gary C. (Eds.), Emerging Standards of International Trade and Investment: Multinational Codes and Corporate Conduct, (1984), New Jersey: Rowman and Allanheld, p. 101, at p. 106.

⁸⁵*Ibid.* at p. 106.

⁸⁶*Ibid.* at p.106.

⁸⁷*Ibid.* at p. 106; See also Baade *supra* n 83 at p. 10.

⁸⁸Baade *ibid.* at p. 35, he gives an example of the American case of Avigliano et al V Summitomo Shoji America Inc., 473 F. Supp. 506 (S.D.N.Y, 1979) where the OECD Code was used in aid of the interpretation of the US - Japanese agreement which authorised contracting states to engage executive personnel of their choice. It was held, based on the OECD Code, that the freedom of selecting the personnel was subject to the OECD guidelines which prohibited discrimination.

As we have shown earlier on there is general agreement on the need to regulate TNCs. Although there is argument against the codes of conduct themselves.

Basically, those who oppose the codes centre their arguments on the fact that codes will interfere in the principles of free market and, therefore, affect the unregulated flow of foreign direct investment to developing countries⁸⁹.

Because of the above argument there has been a disagreement on the legal nature of the codes especially on jurisdictional matters over TNCs and, on the host countries' rights to control the TNC as a whole. Developed countries have been pressing for the voluntary application of the codes⁹⁰. That the codes should not have a binding effect on the parties. TNCs as well as host countries should be free to accept or reject them. On the other hand, developing countries have been pressing for legally binding codes.

Arguably, the above polarisation on the application of the codes has delayed the coming into force of the omnibus code⁹¹. But more importantly, this tension has stopped the drafting process of the Codes at 'a point of consensus', "while the text is still at a level of generality, too high for effective application"⁹². This is one of the reasons why the codes cannot apply to particular relationships such as joint ventures. However, this observation should not be exaggerated, because:

'While some of the provisions are phrased in such vague and general terms that their actual importance remains doubtful, other provisions are reasonably specific as well as original - for instance those on consumer protection, environment and information disclosure'⁹³.

A critical observation of the codes reveals that the provisions which are most specific include those which address the TNC as a whole. However, their importance is diluted by a specific provision on the jurisdiction of host countries over the TNC which is limited to affiliates of the TNCs⁹⁴. Thus, in legal terms the Codes have not solved the problem of the internationalisation of business relationships, apart from providing a framework for international negotiations. In order

⁸⁹But see Gross supra n. 38 at p. 431.

⁹⁰See Baade supra n. 83, at pp. 24 - 28.; See also Brownlie Ian, 'Legal Effects of Codes of Conduct for MNEs', in Horn supra n. 39, at pp. 39 - 43; Fatouros Arghyrios, A., 'The UN Code of Conduct on TNCs: A Critical Discussion of the First Drafting Phase', in Horn op cit. p. 103, at pp. 122 - 123.

⁹¹That is, the General Code, discussed supra pp 182 - 189.; Baade supra n. 83, at pp. 28 - 38 argues that the binding or the not binding nature of the codes does not matter, what matters is the fact that the principles in the codes are adopted as a matter of International Legal policy; See also Brownlie supra n. 90, at p. 39.

⁹²According to Fatouros supra n. 90, at p. 122.

⁹³Fatouros, A. supra n. 84 at p. 110.

⁹⁴According to section 58 of the code supra n. 52: 'An entity of a transnational corporation [not the whole TNC] is subject to the jurisdiction of the country in which it operates'.

to regulate a TNC effectively, the TNC has to be treated objectively for what it is - a group of interdependent entities. A simple but less effective solution would be to subject the TNC as a whole to the jurisdiction of the laws of every country in which it carries on its business operations⁹⁵. A more effective solution, but a difficult one, would be for international law to provide for comprehensive and specific rules and institutions to harmonise national laws, and where there are *lacunae* to provide new regulations. This would, in turn, maintain the independence of those entities which are jointly owned and controlled, such as joint ventures. To be sure, the codes of conduct as they are now do not provide any of these solutions⁹⁶.

5:3:2. TOWARDS THE INTERNATIONAL COMPANY LAW?: THE NEW LEX MERCATORIA.

The proposals made by Professor Schmitthoff on the establishment of the international company five decades ago are as important now as they were then⁹⁷. The above discussion on the codes of conduct has made the need for the international company law more urgent. International law definitely requires an international institution to harmonise, enforce and interpret it.

I. The International Company Law.

Reporting in 1971 the then Director General of the GATT said *inter alia* that:

'...the significance of the multinational corporation is only now beginning to be recognised and addressed. National and international trade law and economic theory largely ignore the fact that many enterprises now operate across national frontiers....It seems that nationals and the multinational corporations will need to work out together the best ways to accommodating the activities of these corporations within the framework of the rules and procedures of international trade'⁹⁸.

Joint venture agreements between TNCs and companies from developing countries or their governments are used to reach a compromise between domestic laws with the wishes of TNCs. There are some concerted international efforts to try to use these agreements to develop an international legal framework for cross-border business relationships. A theory has been developed which contends that through a continuous process of concluding different agreements

⁹⁵The immediate danger of this approach is that the uncoordinated or unharmonised national laws may not avoid collision or conflict.

⁹⁶See Rubin and Hufbauer 'Lessons From the Codes' in Rubin and Hufbauer supra n. 84, at p. 175. They are sceptical about the effectiveness of the codes. At p. 180 they say: 'Among the Codes examined, two must be reckoned as moribund: The UN Illicit Payment Code and the UN Transfer of Technology Code. Another Code is in precarious health: the UN Transnational Corporation Code.'

⁹⁷Refer to fn. 35 supra.

⁹⁸Quoted by Schmitthoff Clive, M. 'The Multinational Enterprise in the United Kingdom', in Hahlo H.R., et al. (Eds.), Nationalism and the Multinational Enterprise: Legal, Economic and Managerial Aspects, (1973), Leiden: Sijhoff, p. 22, at p. 22.

between companies of different nationality, general standards and usage are slowly developing. These indicate a steady development of an autonomous new private international trade law, which some writers have referred to as *lex mercatoria*⁹⁹. It is argued that:

'If all sovereigns agree, subject to certain reservations, to recognise and admit the universal custom of businessmen as a law creating agency, the striking similarity in the international trade in all national legal systems... might, in fact find its explanation in the derivation of that law from a common source'¹⁰⁰.

The sources of *lex mercatoria* may include the general standards of municipal or domestic law which are acceptable internationally. These are mainly domestic laws which represent a compromise between the host country or the domestic company on one side and the TNC on the other¹⁰¹.

Another source of '*lex mercatoria*' may be various bilateral and multilateral agreements or treaties¹⁰². Indeed, *pacta sunt servanda* (the only traditional private international law rule) was developed from these agreements and treaties¹⁰³.

Another source, of course, is international conventions and resolutions, mostly by the UN. In this case UN resolutions on the NIEO and the codes of conduct may be regarded as the source¹⁰⁴. However, it is important to note that not all the provisions of the conventions or resolutions will be involved. It is only those which are generally accepted and which in particular aim at co-operation or compromise to the extent of being used in transnational trade transactions which may be involved¹⁰⁵.

The Importance of Interpretation.

Whether the above sources of *lex mercatoria* are a part of it or not, depends on those who interpret and implement or enforce them. The problems of nationalism or patriotism may induce those who enforce these standards to interpret them in favour of the national party. On the other

⁹⁹Schmitthoff Clive M., 'The Law of International Trade: Its Growth, Formulation and Operation', in Schmitthoff Clive, M. (Ed), *The Sources of Law of International Trade*, (1964), London: Stevens and Sons, pp. 3ff.; See also Schmitthoff Clive, M., *Commercial Law in Changing Economic Climate*, (1981) (2nd. edn.), London: Sweet and Maxwell, especially Ch. 2 on 'The Law of International Trade', pp. 18 - 33; See also De Ly Filip, *International Business Law and Lex Mercatoria*, (1992), Amsterdam: North-Holland.

¹⁰⁰Schmitthoff (1964) *ibid.* at p. 5.

¹⁰¹See our discussion in chapter three p84. and figure 3.2 *supra* where we indicate that most of these laws fall within the interdependence zone; See further Schmitthoff Clive, M. 'International Trade Usages', in a *Special Newsletter of the Inst. of Int. Bus. Law and Practice*, (1987), Paris: ICC, at pp. 9 - 24.

¹⁰²In the case of our study Joint Venture Agreements between TNCs and Local companies from developing countries may be a good example. See the discussion of some of these agreements in the next chapter *infra* pp. 234 -242 and appendix 1 *infra*.

¹⁰³See Goldstajn Alexander, 'The New Law Merchant', *J.Bus.Law*, [1961], pp. 12 - 17.

¹⁰⁴See Horn *supra* n.38, at p. 59.

¹⁰⁵Understanding that those which favour host countries may not be acceptable to TNCs and vice-versa.

hand, the interpreters of municipal or domestic laws could contribute to the development of *lex mercatoria* if they interpreted domestic laws internationally to represent a compromise of interests between local participants and foreign companies (TNCs)¹⁰⁶. *Lex mercatoria* or transnational trade law should have uniformity in its application and interpretation. Because:

'It would be deplorable if the nations should, after protracted negotiations, reach agreement... and that their several courts should then disagree as to the meaning of what they appeared to agree upon'¹⁰⁷.

This means that the language of an internationally agreed standard should be:

'addressed to a much wider and more varied judicial audience than is an Act of Parliament dealing with purely domestic law. It should be interpreted...unconstrained by technical rules of English Law, or by English legal precedent, but on global principles of general acceptance' (sic)¹⁰⁸.

However, having said that, it is very difficult in most cases for parties to be totally convinced that domestic courts and institutions will interpret the laws internationally, unless those courts or institutions are internationally recognised for their impartiality and also have developed legal systems and procedures. *A fortiori*, domestic courts and tribunals from developing countries may be rejected on this ground¹⁰⁹. Thus, the interpretation and enforcement of newly developed business standards (*lex mercatoria*) still lacks both codified standards and an internationally recognised legal institution, analogous to the International Court of Justice to enforce it. Solace has been found in the 'more developed and impartial arbitration tribunals'¹¹⁰.

¹⁰⁶In other words, in deciding cases which involve parties of different nationality it is important to use the relational approach. That is, the decision should consider the interests of other nationals involved, and the fact that the judgement will be interpreted or even enforced by courts of other nationalities, with different economic, political and cultural backgrounds. See further, Schmitthoff supra n. 101, at p.31.

¹⁰⁷According to Lord Viscount Simmonds in *Scruttons Ltd. V Midland Silicones Ltd.* [1962] A.C. 446, at p. 471; See also *Riverstone Meat Co. Pty. Ltd. V Lancashire Shipping Co. Ltd.* [1961] A.C 807.

¹⁰⁸According to Lord Diplock in *Fothergill V Monarch Airlines Ltd.* [1981] A.C 251, at pp. 281 - 282; See also *James Buchanan & Co. Ltd. V Babco Forwarding and Shipping (U.K) Ltd.* [1978] A.C 141, at p. 152 per Lord Wilberforce; In *Stag Line Ltd. V Foscolo Mango and Co. Ltd.* [1932] A.C, 328, Lord Macmillan, at p. 350 said: 'As these rules must come under the consideration of foreign courts, it is desirable in the interest of uniformity that their interpretation should not be rigidly controlled by domestic precedents of antecedent date, but rather that the language of the rules should be construed on broad principles of general acceptance'.

¹⁰⁹See our discussion infra pp 194 - 196 and n. 117. This is one of the reasons given by joint venture companies studied in the next chapter when asked why they prefer international arbitration to local ones.

¹¹⁰An attempt was made in the case of *Pabalk Ticaret V Norsolor* Y.B Commercial Arbitration, ICC award No. 3131, see also 24 *I.L.M* (1985) 360 (concerning an agreement between a Turkish company and a French company) to use the principles of *lex mercatoria*. In justifying for the use of these principles the arbitration tribunal said: 'Faced with the difficulty of choosing a national law the application of which is sufficiently compelling, the Tribunal considered that it was appropriate, given the international nature of the agreement, to leave aside any compelling reference to a specific legal system, be it Turkish or French, and to apply the international *lex mercatoria*.. But later in the appeal in the French court the application of *lex mercatoria* was dismissed as a "world law of questionable validity", loc cit at p. 361.

II. International Arbitration.

This study will not analyse in detail the non-court dispute settlement procedures resorted to by parties to joint ventures formed in developing countries. Nevertheless, the fact that cross-border investments, are often subject to international arbitration institutions (probably as the only available international institutions) should be analysed, albeit within the context of searching for an international institution for the enforcement of internationally recognised trade standards. Indeed, several writers¹¹¹ see international commercial arbitration tribunals emerging as independent and autonomous institutions to arbitrate and interpret the new international trade law, and through that process to contribute to its development.

The UN also recognises the importance of international commercial arbitration. In 1966 the New York Convention established the International Centre for Settlement of Investment Disputes (ICSID)¹¹². Although this centre takes care of disputes which involve states and nationals of other states, several joint venture cases have been settled by this centre¹¹³.

Joint ventures involving private business enterprises normally use the services of the International Chamber of Commerce (ICC) (which has its headquarters in Paris), the London Court of International Arbitration (LCIA) and the American Arbitration Association (AAA)¹¹⁴. These institutions have their own rules of procedure. But because of the increase in international or transnational enterprises which require their services, they are trying to make their rules more

¹¹¹See for example, Schmitthoff Clive, M., 'Universalism and Regionalism in International Commercial Arbitration', in Schmitthoff and Simmond Kenneth, R. (Eds.) International Economic Trade Law, Universal and Regional Integration, (1976), Leyden: Sijhoff, pp. 171 - 181. Schmitthoff Clive, M., 'The Jurisdiction of an Arbitrator', reproduced in Cheng supra n. 35, pp. 628 - 636; Schmitthoff Clive, M. 'Extrajudicial Dispute Settlement' in Cheng op cit, pp. 637 - 653; Schmitthoff Clive, M. 'Finality of Arbitral Awards and Judicial Review', in Cheng op cit, pp. 654 - 662; Gremade Bernado, M. , 'Multinational Companies and Commercial Arbitration', in Horn supra n. 38, at pp. 83 - 93; De Viries Henry, P. 'International Commercial Arbitration: A Contractual Substitute for National Courts' 57 Tul.L.Rev., (1982), 42; Verboon Gary and Dorda Monika, 'Arbitration and Enforcement of Arbitration Awards', in Campbell Dennis and Peter Summerfield, (Eds.), Effective Dispute Resolution for the International Commercial Lawyer, (1989), Deventer: Kluwer Law and Taxation Publishers, p. 89, at p. 91; Polonsky Michael, 'Arbitration of International Contracts', J.B.L., [1971], 1..

¹¹²Tanzania become a member of this Organisation in 1991.

¹¹³For example, AGIP V The Peoples Republic of Congo, Benvenuti and Bonfant V The Peoples Republic of Congo, Gerdella V Ivory Coast, these cases are discussed by Aaron Broches, 'The Experience of International Centre for Settlement of Investment Disputes' in Rubin Seymour J. and Nelson Richard, W. (Eds.) International Investment Disputes, (1985) New York: West Publishing Co. pp. 75 - 97. As these cases are about compensation and expropriation, they do not discuss issues of joint venture companies. Indeed the so called joint ventures were formed after nationalisation. There are therefore "forced joint ventures", see ch. 2 supra pp. 18 - 21.

¹¹⁴See Aaron Sam, 'International Arbitration II: The Main Centres', 108 South African Law Journal, (1991), pp. 93 - 117.

international by modifying them according to the UNCITRAL Model Rules of 1976¹¹⁵. Partners to joint ventures are advised to have full knowledge of these rules first, before they agree to use them in their joint venture agreements.

International arbitration tribunals are mostly regarded as places where TNCs can have fair and neutral trials¹¹⁶. Concerns have been expressed by African writers¹¹⁷ that developing countries, especially African countries are lagging behind in efforts to develop internationally acceptable arbitration tribunals.

However, the role of tribunals in enforcing international business transactions should not be exaggerated. Unless elements of conciliation and mediation are given their importance in the process of arbitration of the joint venture company matters, the court's adversarial procedures, rather than restoring co-operation, should be anticipated. Moreover, the review, recognition and enforcement of tribunals' awards requires the use of domestic courts and other enforcement agencies. Thus, the domestic courts cannot be totally ousted¹¹⁸.

5:4. THE REGIONAL COMPANY LAW: EEC, AEC AND ASEAN COMPARED.

Regional and sub-regional economic co-operation among countries is probably the major pattern of economic co-operation of our times. It started with the European Economic Community (EEC) in 1950s¹¹⁹, and has now reached almost everywhere¹²⁰. In developing countries

¹¹⁵*Ibid.* pp. 95 - 116; These rules were adopted by the UNCITRAL on April 28, 1976. They are reproduced in 15 I.L.M., (1976), pp. 701 - 717.

¹¹⁶See Aaron Sam, 'International Arbitration I: Drafting an Arbitration Clause for International Commercial Contracts', 107 South African Law Journal, (1990), 633, at pp. 633 - 639. Some of the joint venture Agreements discussed in the next chapter resort to international arbitration tribunals, see pp. 234 - 242 and appendix 1 *infra*; But see also Tupman Michael, W. 'Challenge and Disqualification of International Commercial Arbitration' 38 I.C.L.Q., (1989), 26; However, there is an argument that domestic courts cannot be ousted, they are needed to recognise, review and even enforce the judgements by the tribunals, see De Ly *supra* n. 99, pp. 133 - 203; See also Schmitthoff Clive, 'Finality of Arbitral Awards and Judicial Reviews', in Juliana Lew, D.M., (Ed.), Contemporary Problems of International Arbitration, London: Centre for Commercial Law Studies, pp. 230 - 237; See also Campbell and Peter *supra* n. 111.

¹¹⁷See for example, Bondzi-Simpson *supra* n. 71, pp. 94 - 95; Sempasa Samson, L. 'Obstacles to International Commercial Arbitration in African Countries' 41 I.C.L.Q., (1992), 387; Soranarajah, 'The UNCITRAL Model Law: A Third World Viewpoint' 6 J.Int. Arbt., (1989), 7, at p. 10.

¹¹⁸For the discussion on the importance of conciliation and mediation in the joint venture company see our discussion in chapter four *supra* p 118 - 119. For the inevitability of the court see footnote 116 *supra*.

¹¹⁹See Folsom Raph, H. Corporate Competition Law in the European Community, (1978), Toronto: Lexington Books, especially Chs. 1&2 where he talks about the European Integration, its advantages and disadvantages.

¹²⁰To include countries with huge markets like USA. Negotiations have been concluded recently for the establishment of North American Free Trade Area (NAFTA) between USA, Canada and Mexico, see generally

(especially in the African countries) co-operation is mainly sub-regional. The aim of the Organisation for African Unity (OAU) since its inception in 1963, has been to establish the African Economic Community (AEC) from the sub-regional co-operation. This was fulfilled, at least on paper, in 1991¹²¹. Our study will use examples of the EEC, the AEC and the ASEAN PTA to analyse different steps already taken towards the development of the Regional company law, aimed *inter alia*, at regulating cross-border joint venture companies.

5:4:1. THE EUROPEAN COMPANY LAW.

Attempts in the European Economic Community to develop the European Company (*Societas Europaea* or *SE*) are perhaps as old as the Community itself¹²². According to Article 54(3)(g) of the Treaty, measures should be taken by the Community to secure freedom of establishment by:

'co-ordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by the Member States of companies and firms... with the view of making such safeguards equivalent throughout the community'.

Different directives which aim at harmonising the company laws of EEC countries are based on this Article¹²³. However, because of the inadequacy of directives the EEC has utilised the provisions of Articles 85, 86, 100a and 235 of the Treaty to enact regulations on competition and on the establishment of the legal framework for some business organisations. Structures like the European Economic Interest Group and the European Company (SE)¹²⁴ will be analysed in this context.

(I) Directives.

It was noted in the fourth chapter that the EEC Company Law Directives have influenced change in the Company Laws of member states. There is a steady movement from classical principles and

articles written in Melo Jaine and Panagariya Arvind, *New Dimensions in Regional Integration*, (1993), Cambridge: Cambridge University Press, specifically an article by Whalley John, 'Regional Trade Arrangements in North America: CUSTA and NAFTA', at pp. 352 - 382. The Treaty is reproduced in 32 I.L.M. (1993), 605.

¹²¹See 30 I.L.M., (1991), 1241.

¹²²The 1957 Rome Treaty establishes the European Community. The literature on this is enormous, but for purposes of our reference these are important: Dine Janet, *EC Company Law*, (1991), London: Chancery Publishing House; Werlauff Erik, *EC Company Law*, (1993), Copenhagen: Jurist-Og Okonomforbundets Forlag; Wooldridge Frank, *Company Law in the United Kingdom and the European Community: Its Harmonization and Unification*, (1991) London: Athlone Press.

¹²³Dine *ibid.* para 1.44 - 1.45.

¹²⁴See our discussion *infra* pp. 249 - 263.

theories (e.g. the entity theory) towards the relational approach to match the conditions in which EEC companies find themselves. A general analysis of these directives shows that there is an acknowledgement that: (i) the activities of corporate enterprises transcend the frontiers of national territory¹²⁵; (ii) many companies in the Community have a transnational structure¹²⁶; (iii) partners and creditors of companies ought to have equal protection and similar information in all members states¹²⁷; and that, (iv) there should be equal minimum legal conditions for the companies competing with each other¹²⁸.

The first and second directives provide for the minimum standards required for the formation of public limited companies¹²⁹. They also require that the documents necessary for the formation should be made public¹³⁰. The application of these directives to UK Companies has been discussed in chapter four¹³¹.

The fourth Directive regulates the drawing up of accounts of individual companies¹³². However, this directive has to be read together with the Seventh and Eleventh Directives which deal with the consolidation of accounts of companies with those of their subsidiaries or branches which are under the same control¹³³. Thus, the two latter directives are important as far as the regulation of Transnational corporations is concerned, albeit for accounting purposes.

These directives are important to transnational joint venture companies because they introduce a new concept of parent undertakings, which is not limited to majority share-holding or having majority of board members, but also indicates that control can be inferred when the parent undertaking exercises a dominant influence over other undertakings and when it enters into a control contract with them¹³⁴. This definition applies even in the circumstances where the two undertakings are not directly connected, provided there is a unified management¹³⁵.

Cross-national joint venture companies will not be included in the consolidated accounts, if it is proved that they do not fall within the above definition of control. The existence of a joint venture

¹²⁵Dine supra n. 122 para 1.9, these views are on the preamble to the 2nd Company Law Directive.

¹²⁶Dine ibid; See also the preamble to the 9th Company Law Directive.

¹²⁷Dine ibid. See also the preamble to the 1st, 4th, and 7th Company Law Directives.

¹²⁸Dine ibid. See also the preambles to the 4th and 5th Company Law Directives.

¹²⁹An updated text of these Directives appears in the EEC, Harmonisation of Company Laws in the European Community: Measures Adopted and Proposed: Situation at March 1992, (1992), Brussels: EEC.

¹³⁰Ibid. Articles 2 - 6 of the 1st Directive and Arts. 2 - 5 of the 2nd Directive. pp. 10 - 11 and 18 - 19 respectively.

¹³¹Supra pp. 84 - 170.

¹³²See n. 129 supra, pp. 43 - 63.

¹³³Ibid. at pp. 77 - 93 on the 7th Directive, and pp. 107 - 111 on the 11th Directive.

¹³⁴Ibid. Art. 1 of the 7th Directive, at p. 78.

¹³⁵Ibid. Art. 1(2).

company may be implied where there are long-term restrictions on the right of parent undertakings to exercise exclusive control (in particular, by way of a unified management) over affiliate companies¹³⁶. This means that in order to be regarded as a joint venture company, and therefore not subjected to consolidated accounts, the company must be independent of the parents as a matter of fact and law.

However, the above directives are limited only to accounts. Questions remain as to whether the parent-subsidiary undertaking relationship can be extended to both the internal and the external relations of undertakings. This depends on the importance given to the two directives (now still in the proposal form), namely the fifth directive, which deals with the internal relationships, and the ninth directive, which deals with the external relationships of groups of companies.

As seen in the fourth chapter¹³⁷ the fifth directive is intended to regulate the internal structure of the company. The centre of controversy, which has delayed its acceptance, is on employee participation in the decision making of the company¹³⁸. This issue becomes more complicated when applied to cross-national joint venture companies. According to Article 4 of the proposed directive workers employed by subsidiary undertakings of the company shall be considered to be employees of that company¹³⁹. But issues of participation of these employees in the decision making of the group are left at the discretion of member states 'pending to subsequent co-ordination'¹⁴⁰. To be sure, the subsequent co-ordination cannot be complete unless the issue of groups of companies is resolved.

The draft proposal for a directive on groups of companies was initiated in 1984¹⁴¹. It aims at presenting rules which would have a harmonising effect on groups of companies. As discussed elsewhere, the concept of group of companies intends to legalise the dominant-dependent relationships between related undertakings and thereby establish the liability of dominant undertakings towards the dependent ones, when the latter suffer loss because of their dependence on the former. Although Werlauff¹⁴² indicates that the concept of a group of companies already exists in the directives on accounts, full implementation is not in the near future¹⁴³.

¹³⁶Article 13(a): Werlauff *supra* n. 122 pp. 365 - 366.

¹³⁷*Supra* pp. 123 - 127.

¹³⁸Dine *supra* n. 122 paras 1.27 - 1.28.

¹³⁹*Supra* n. 129 pp. 209 - 210.

¹⁴⁰*Ibid.* Article 63(b) p. 239.

¹⁴¹Dine *supra* n. 122 Ch. 9 para 9.1.

¹⁴²*Supra* n. 122, pp. 360 - 365.

¹⁴³This is because the proposed 9th Directive has been removed from the updating process, it does not appear in fn 129 *supra*.

Generally speaking the directives do not add much to the development of the EEC Company Law. Moreover, their absorption into the company laws of the members may lead to different results because of the choices they leave open. Further, if harmonisation becomes a major objective, important issues which may not be accepted by some member states may be forgotten. Harmonisation is acceptable when it does not endanger relationships between the member states. Dine¹⁴⁴ quotes Buxbaum and Hopt¹⁴⁵ who make a point that:

'Legal harmonisation can be a palliative for the failure of progress in truly European market integration, particularly if relatively minor side issues are taken up as second best candidates for harmonisation and if the dissent over the key issues is camouflaged by harmonisation of details and technicalities'.

This may be the reason for the neglect of some important aspects which need immediate harmonisation, such as groups of companies. If this trend is not reversed, it may take a long time to harmonise the laws which regulate new structures such as joint ventures. This is not only because these laws are not yet well established in member countries' legislation, but also because joint venture companies' existence is essentially transnational and therefore concerns the treatment of groups of companies.

(II) In Search of the Legal Framework for Cross-national Joint Ventures: The EEC Regulations.

In recognition of the directives' inability to regulate trans-border business structures such as joint venture companies the EEC has utilised the provision of Article 235 to enact regulations¹⁴⁶ establishing structures like the European Economic Interest Grouping (EEIG)¹⁴⁷. A proposed regulation establishing the European Company (SE) is also being considered¹⁴⁸.

(i) The European Economic Interest Grouping (EEIG).

This is a new business structure within the EEC¹⁴⁹. It is described as "the first truly European -

¹⁴⁴Supra n. 122, at para 1.10.

¹⁴⁵See the original discussion in Baxbaum and Hopt Legal Harmonisation and the Business Enterprise, (1988), European University Inst. at p. 204.

¹⁴⁶Article 235 provides: 'If action by the Community should prove necessary to attain, in the course of the operation of the Common Market one of the objectives of the Community and the Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, take the appropriate measures'.

¹⁴⁷See Warlauff supra n. 122, pp. 39 - 42; Wooldridge supra n. 122, pp. 103 - 117; Dine supra n. 121 Ch. 2.

¹⁴⁸Dine *ibid.* Ch. 3; Schmitthoff Clive, M. and Simmonds K.R., European Company Law Text, (1973) London: Stevens and Sons; For the latest proposal of the SE see supra n. 128, at p. 319ff.

¹⁴⁹See n. 129 supra pp. 183 - 193; See also SI 1989/638, Sch. 1 of the English Companies Act, (1985) as amended in 1989, Vol 2 (6 edn.), paras 86, 932 - 85,992.; See also Official Journal (OJ) No. L. 199/1; See also Department of Trade and Industry (UK) (DTI), Draft EEC Regulation on The European Economic Interest

rather than national - legal framework for the exercise of economic activities"¹⁵⁰.

The preamble to the regulation provides clearly that the EEIG differs from a firm or a company. Principally, the difference centres on its purpose. The EEIG is to facilitate or develop the economic activities of its members to enable them improve their own results and undertakings¹⁵¹.

The EEIG is established through a formation contract. However, like the company constitution the contract has to be registered in the member country where the EEIG has its official address and centre of administration¹⁵². Some of the contents of the contract are provided under Article 5 of the regulation. Further, the contract, together with other documents have to be made public¹⁵³.

The members of the EEIG can include companies, firms and other legal bodies as well as natural persons. They have to have a common business activity. They should also be from different member states. New members may be accepted. In some member countries however, membership is limited to twenty¹⁵⁴.

The regulation accords legal power (capacity) to the EEIG in its own name. It has rights and obligations of all kinds. In particular, it can enter into contracts, and sue and be sued¹⁵⁵. However, it is for the member countries to decide whether the EEIG should be accorded legal personality or not¹⁵⁶.

The liability of the grouping is unlimited. Members are jointly and severally liable. This liability binds the member for a period of up to five years after it has ceased to be a member¹⁵⁷.

The grouping has perpetual succession, unless members, in the contract for formation or by a unanimous decision, provide for its life span¹⁵⁸.

The structure of the EEIG consists of two organs, namely the members and the manager or

Grouping (EEIG): A Consultative Document, (1983 and 1986), London: DTI; Williams Fox, An EEIG for You, (1992), London; Anderson Margaret, European Economic Grouping, (1990), London: Butterworths; Keegan Sabina, 'The European Economic Interest Grouping' J.B.L., [1991], 457.

¹⁵⁰EEC, EEIG: The Emergence of a New European Co-operation: Review of Three Years Experience, (1993), Brussels: EEC, at p. 1.

¹⁵¹Supra n. 129, at p. 185, para 9.

¹⁵²Ibid. article 12.

¹⁵³Article 8.

¹⁵⁴Article 4, specifically art. 4(3).

¹⁵⁵Art. 1(2); Dine supra n. 122, para 2.14.

¹⁵⁶Art. 1(3).

¹⁵⁷Art. 37.

¹⁵⁸Art. 30.

managers¹⁵⁹.

The members' meeting is the supreme organ of the EEIG. It has to reach its decisions unanimously. Each member has one vote. The contract for formation may accord to some members more votes. It may also provide that the decision be reached by a majority vote, provided no one member alone has a majority vote. However, this decision is only in those matters which do not require a statutory unanimous decision¹⁶⁰.

The powers of the manager(s), together with the conditions for their appointment or removal from office, if not set out in the contract for formation, must be determined by a unanimous decision of the members¹⁶¹. The manager has the power to bind an EEIG. The restriction of this power either by the contract for formation or by the members does not affect a third party¹⁶².

Employees are not recognised as one of the organs of the EEIG. However, a provision is made that the employees of the EEIG should not exceed 500¹⁶³.

The EEIG need not have capital. Members are left to determine the manner and mode of contribution, either in cash, kind or in service whenever a need for contribution arises¹⁶⁴. However, they have to utilise the proceeds of their contribution according to the contract for formation. If there are no such provisions in the contract, they have to share the proceeds equally¹⁶⁵.

The termination (winding up) of the EEIG may be voluntary or compulsory. It is voluntary when members, unanimously, so decide¹⁶⁶. A member may apply to the court for a compulsory winding up on proper and just grounds¹⁶⁷. This application may also be made by a competent (government) authority when the public interest is in danger¹⁶⁸.

After the process of winding up, the EEIG has to be liquidated according to the national laws of

¹⁵⁹Art. 16.

¹⁶⁰Art. 17.

¹⁶¹Art. 19.

¹⁶²Art. 20.

¹⁶³Art. 3(2) (c).

¹⁶⁴Art. 21(2); See also Israel Severin, 'The EEIG - Major Step Forward for Community Law' 9 Co. Lawyer, (1988), No. 1, pp. 15 - 22, at p. 18.

¹⁶⁵Art. 12 *ibid.*; see also Israel *ibid.* at p. 18.

¹⁶⁶Art. 31 of the Regulation.

¹⁶⁷Art. 32(1) & (2).

¹⁶⁸Art. 32(3).

the member country in which it is registered¹⁶⁹.

The EEIG and the Joint Venture Company.

Although it is provided in the preamble to the Regulation that the EEIG is not a company or a firm, there is no agreement yet whether in fact the EEIG is a joint venture company or a joint venture partnership. Fox Williams¹⁷⁰ is of the view that the EEIG is neither a merger, a joint venture nor a European Company. Whereas Anderson¹⁷¹ suggests that:

'The groupement (sic) is a joint venture, save that it (sic) has a legal personality'.

She continues to note that the EEIG is only different from the joint venture because of the fact that the former has a specific law while the latter has not¹⁷².

The views of Anderson are not shared by other writers such as Wooldridge¹⁷³ and Dine¹⁷⁴ who see an EEIG as 'partnership-like', 'a quasi-partnership' or 'a unique transnational partnership'.

The difference between the EEIG and the company may not be clear, especially when one uses the entity or the incorporation approach to determine the nature of the company. According to the English law for example, the EEIG, just like the company, acquires its legal personality from the date of incorporation¹⁷⁵. The difference between these two structures therefore can only be discovered from the analysis of the circumstances which lead to their formation and not from the act of incorporation¹⁷⁶. Perhaps when the difference between the company and the EEIG is made clear, the difference between the latter and the joint venture company will become clearer.

The first obvious difference is based on the way the two structures are formed. While the company's formation is more complex and is done by the registration of the company's constitution, which comprises the memorandum and articles of association, the EEIG can only be formed by the registration of the contract for formation. However, this difference may not be very important because of the argument that the company's constitution is also its contract for

¹⁶⁹Art. 35.

¹⁷⁰Supra n. 149, at p. 1.

¹⁷¹Supra n. 149, at p. 11.

¹⁷²Ibid. at p. 11.

¹⁷³Supra n. 122, at p. 115.

¹⁷⁴Supra n. 122, at para 2.1, Ch. 2.

¹⁷⁵According to Regulation 3 of the English European Economic Interest Grouping Regulations of 1989, (S.I. 1989, No. 638) reproduced in Anderson supra n. 149, pp. 180 - 197, also appended to the English Companies Act, 1985, as amended in 1989, Vol. 2 (6 edn.), para 85, 883.; See also Keegan Sabina supra n. 149.

¹⁷⁶See our discussion in Ch. three supra pp. 73 - 76.

formation¹⁷⁷. Thus, the difference should not be based on the issue of whether the company's constitution is a contract or not, but on the purposes for which parties decide to form the company or the EEIG.

The objectives for the formation of the company differ considerably from that of an EEIG. While the company may be formed for an extremely wide variety of purposes, restricted only by the fact that those objectives should be lawful, the EEIG on the contrary, can only be formed to facilitate or develop the economic activities of its members and to improve or increase the results of these activities¹⁷⁸. According to Israel¹⁷⁹ this implies two kinds of general restriction:

Firstly, an EEIG should not be used to create a new activity that has no connection with the activities of its members. [Because] this would necessitate the founding of the company. Secondly, the EEIG must not replace the activities of its members or become so important that their activities are taken over by it or become dependant on it. If that were to happen the grouping would behave like a company and its legal form would be no more than a camouflage'.

In essence therefore, the activities of the EEIG are ancillary, auxiliary to, or a catalyst of the business of its members.

Another difference is the fact that unlike the company, and, to some extent, the partnership, the EEIG's economic existence is dependent on its members. This is because according to the regulation the EEIG is not supposed to make profit of its own. Rather than being a profit centre, the EEIG is a cost centre¹⁸⁰. This shows that although the EEIG may be a legal entity, it is by no means an economic entity.

For this reason, the EEIG unlike the company, is tax neutral. Whatever income or profit it makes is taxed in the hands of its members¹⁸¹. For the same reason the EEIG is not required to file an annual return to the registrar.

Thus, the EEIG need not have capital in the same way as a company.

Again, unlike the company, the relationship between the EEIG and its members or other undertakings is restricted. An EEIG should not hold a controlling interest in a member or another undertaking¹⁸².

¹⁷⁷See our discussion in chapter four supra pp. 90 - 97.

¹⁷⁸Art. 3(1) of the Regulation.

¹⁷⁹Supra n. 164, at p. 15.

¹⁸⁰Williams Fox supra n. 149, at p. 9.

¹⁸¹Art. 40; Israel supra n. 164, at p. 15.

¹⁸²Art. 3(2).

The internal structure of the EEIG is simpler than that of the company. Members of the EEIG are not required to have general meetings. Further, the concept of employee participation in the decision making of the EEIG is not necessary. After all the employees of the EEIG are limited to 500.

A general analysis of the differences between the EEIG and the company reveals that the EEIG has been invented to take care of simpler cross-border business relationships based on a low level of interdependence. Thus, the activities of the EEIG do not jeopardise the independence of its members. Moreover, regulations have been provided to restrict the EEIG from controlling its members or other undertakings. On the contrary, the business relationship within a company is more complex, showing a higher level of interdependence which needs to be conducted through more independent structures, both legally and economically.

However, one shortcoming of the EEIG is that although it claims to be a novel structure, it is formed and regulated mostly by the laws of the member countries. Most of these laws are by no means new. For example, the regulations which legalised the establishment of EEIG in the UK adopted a good part of company law¹⁸³. It remains to be seen whether this does not amount to putting new wine in old bottles. Indeed, this may add to the confusion between the company and the EEIG or between the EEIG and the joint venture company.

The difference between the joint venture company and the EEIG can be considered first and foremost in the light of the difference between the company and the joint venture company, discussed elsewhere in this study¹⁸⁴. The difference between the company and the EEIG discussed above can then be used to determine the difference between a joint venture company and an EEIG.

The joint venture company bears some resemblance to the EEIG in its instruments of formation. For both structures contracts are the main documents for their formation. However, the joint venture company has to have, in addition, a memorandum and articles of association in order to be formed as a company¹⁸⁵.

Perhaps the factor that distinguishes the joint venture company from the EEIG is the requirement that the joint venture company should be both economically and legally independent of its parents.

¹⁸³See *supra* n. 175.

¹⁸⁴See our discussion in chapter two *supra* pp. 46 - 49.

¹⁸⁵See our discussion chapter four *supra* pp.90 - 97.

This is not yet legally provided in the EEC company laws, because so far, there is no company law which specifically deals with joint venture companies. Our research has emphasised this importance. It seems this is also the position of EEC Competition Law which *inter-alia* regulates joint venture companies. According to this law it is now settled that:

'The joint venture [company] is an autonomous entity....[It] stand[s] as separate identifiable company on the market with all the assets necessary to play a role distinct from its parents... the joint venture [will not] simply undertake an auxiliary function for its parents'¹⁸⁶.

This analysis means that the EEIG cannot be used as a vehicle for a joint venture company. Arguably, it cannot be used as a vehicle for a joint venture partnership either¹⁸⁷. The EEIG may be used as a vehicle for a joint venture in situations which lie in the 'grey' area between the joint venture partnership and the joint venture company¹⁸⁸. The advantages of the EEIG being used as a joint venture are yet to be seen. Wooldridge¹⁸⁹ notes:

'Although it is difficult to predict how popular the grouping will become, the partnership-like system of unlimited liability, and perhaps the detailed publicity requirements, may also act as a disincentive for its use. Business undertakings wishing to engage in a cross-frontier co-operation involving the creation of some common body may still prefer to form a joint subsidiary, or to enter into some kind of contractual arrangement'.

However, given the fact that the EEC has not yet provided a legal framework for the formation and operation of joint venture companies, the EEIG remains the only instrument of co-operation between companies of different EEC nationality¹⁹⁰.

(ii) The European Company (SE).

Unlike some proposals for EEC Directives which have been shelved, the proposal for the EEC

¹⁸⁶This is according to the decision in the EC case of Lucas V Eaton, EEC [1991] O.J C 328/15 also referred to by Overbury, Colin, The EEC Merger Regulation, (1992), London: Sweet and Maxwell at p. 55; In cases where joint venture companies or subsidiaries are not economically independent EEC has used the principles of piercing the veil of incorporation, in particular, the single economic entity rule to make parent companies liable. See for example, Imperial Chemical Industries Ltd. V Commission, [1972]. C.M.L.R., 557. In Europemballage and Continental Can Company Inc. V EC Commission, [1973], C.M.L.R., 199 (case 6/72) the single entity rule was expanded to include the attribution of conduct of a non-EEC parent company. See generally Fine Frank, L. Mergers and Joint Ventures In Europe: The Law and Policy of the EEC, (1994) (2nd. edn.), London: Graham and Trotman. However, these principles are applied as far as the competition law is concerned. One doubts whether they can apply to companies generally, see for example, Hofstetter Karl, 'Parent Responsibility for Subsidiary Corporations: Evaluating European Trends', 39 I. C. L. Q., (1990), 576

¹⁸⁷Because a joint venture partnership, like the normal partnership has to be established with a view of making profit, not as a cost centre. See Millan David and Flanagan Terence, Modern Partnership Law, (1983), London: Croom Helm, at p. 3: See also our discussion in chapter two pp. 41 - 46.

¹⁸⁸See figure 2.1 in chapter two supra p. 51.

¹⁸⁹Supra n. 122, at p. 115.

¹⁹⁰See EEC (1993) supra n. 150.

Company Statute has been updated and reported from time to time¹⁹¹. Dine¹⁹² is of the view that the European Company Statute (ECS) is an attempt to by-pass the obstacles encountered in the harmonisation process through directives, by leaving the determination of such matters to the national laws. However, we shall see later in this part that this approach may in itself be a problem rather than a solution.

According to the latest proposal for the Statute¹⁹³ it is expected that the SE will be both legally and economically independent. The preamble to the Statute emphasises that:

'it is essential to ensure as far as possible that the economic unit and the legal unit of business in Europe coincide'¹⁹⁴.

The SE will be formed by two or more Community based and registered Public Limited Companies (PLCs) of different member states, through one of the following methods: (a) merging, whereby a merger company is formed; (b) forming a joint holding company; and, (c) forming a joint subsidiary company or a joint venture company¹⁹⁵.

These companies have to register themselves in the country where their statutory office and central administration are established¹⁹⁶. Thus, they will be formed according to the company law of the country of registration. This solves the problem of deciding whether to use the law of incorporation or the law of seat of administration¹⁹⁷.

As far as the formation of joint venture companies is concerned the ECS requires that the administrative or management board of each of the founder companies should draw up draft terms for the formation of the joint venture company including: (a) the type, name and registered office of the founder companies and that of the proposed joint venture company; (b) the size of the share holdings of the founder companies in the joint venture company; and, (c) the economic reason for the formation of the joint venture company¹⁹⁸.

It is further provided that founder companies incorporated under the national laws of member countries shall be subject to all the provisions governing their activities in the formation of the

¹⁹¹The latest version appears in n. 129 *supra*, pp. 319 - 485.

¹⁹²*Supra* n. 122, at para 3.1, Ch. 3.

¹⁹³*Supra* n. 129.

¹⁹⁴*Ibid.* p. 347, para 9.

¹⁹⁵Art. 2

¹⁹⁶Art. 5

¹⁹⁷See chapter three *supra* p.79 - 80.

¹⁹⁸Art. 34.

subsidiary in the form of PLC under national laws¹⁹⁹.

Joint venture companies formed according to the above procedure would also have to obey general provisions provided in the ECS.

For example, the minimum capital for their formation should not be less than 100,000ECU²⁰⁰. This capital has to be divided into shares to be issued to the members. Where the shares are issued for a consideration other than cash, that consideration must be transferred to the SE in full within at most 5 years of the registration of the SE. The provisions of the laws of members states as regards valuation shall apply²⁰¹.

The shares may be issued on a pre-emptive basis, but this is subject to the class rights in SEs where shares are issued in classes, as is likely to be the case in joint venture companies²⁰².

Title IV of the ECS concerns the internal structure and governing body of the SE. It adopts the provisions of the 5th Directive which have been discussed elsewhere in this study²⁰³.

Title V is on accounts and it adopts also the provisions of the 4th, 7th, 8th and 11th Directives²⁰⁴.

Title VI is intended to deal with the external relations of founder companies with the SE, namely the concept of groups of companies. According to article 114(1) (now deleted):

'Where an undertaking controls an SE, the undertaking's consequent rights and obligations relating to the protection of minority shareholders and third parties shall be those defined by the law governing public limited companies in the states where the SE has a registered office'.

It is submitted that this provision does not add much to the concept of groups of companies. Its reference to the laws of member states allows those countries which do not apply the concept to continue disregarding it. Thus, although joint venture companies could be formed as SEs, their independence against the founder companies is left vulnerable.

Title VII of the ECS is on winding up and liquidation. According to the draft Statute the process of winding up and liquidation has to be regulated by the law of the member state in which the SE

¹⁹⁹Art. 35(2).

²⁰⁰Art. 4.

²⁰¹Art. 38.

²⁰²Art. 44. See the Appendix 1 *infra*.

²⁰³*Supra* pp. 198 - 199.

²⁰⁴*Supra* pp 198 - 199.

is registered²⁰⁵. This also may be inappropriate to the process required by termination of joint venture companies which can differ from that of other companies²⁰⁶.

The general analysis of the proposed ECS is that it leaves a great deal to be desired. Especially as far as joint venture companies are concerned. Nevertheless, the Statute recognises joint venture companies as one type of SEs and thereby, seeks to provide the legal framework for them. However, this framework is nothing more or less than the recognition of the establishment of joint venture companies as one type of the SEs. Unlike mergers which have more provisions in the ECS, article 34, which is the only specific article on joint venture companies assumes that national laws, governing the formation of other types of subsidiaries, can also apply to joint subsidiaries or joint ventures. But the joint venture company is different from the normal subsidiary company²⁰⁷. It has at least to be controlled and operated by two or more parties who are sometimes of different nationality.

Although the independence of a joint venture company is central to its existence, it is not emphasised anywhere in the ECS. Neither is a concept of groups of companies which would have helped to maintain the joint venture company's independence. One important thing which should be recognised in drafting the ECS is that unlike mergers or take-overs after which the activities of the founder members cease, the formation of the joint venture company as a SE does not diminish the independence and therefore the activities of the founder members or of the joint venture itself. This trio of independence, if not protected by law, may be difficult to maintain. It may be true that the EEC Competition Law fills the gap left by the ECS, but are two types of law mutually exclusive? Indeed, competition laws may be more easily policed if company laws provide guidelines for the formation and operation of independent joint venture companies.

An argument that these guidelines or laws are to be provided by the member state in which a joint venture company is registered should be rejected as a second best solution. Such laws do not exist in some of the member countries, and in any event, the joint venture company is essentially supranational. The view of the UK Government on this issue is that:

'...a particular short-coming of this proposal is the heavy reliance on national law. This means that there will be substantial differences between the laws governing the SEs formed in different Member States. Thus, instead of creating a single legal framework for a supranational company, the SE will give rise to at least twelve versions'²⁰⁸.

However, one may speculate that the problem goes beyond the technical drafting of the ECS.

²⁰⁵ Arts. 116(2) & 120(2).

²⁰⁶ See our discussion in chapter four *supra* pp. 161 - 165.

²⁰⁷ See our discussion in chapter three on groups of companies *supra* pp. 77 - 80.

²⁰⁸ DTI, Proposal for A European Company Statute: A Consultative Document, (1989), London: DTI, at p. 9.

Dine²⁰⁹ suggests that major obstacles in the area of tax, groups, insolvency and worker participation have to be solved before the establishment of the SE. Arguably, these are the problems which have required excessive reliance on the national laws of member countries, thereby making the whole idea behind the establishment of the SE less important. De Ley²¹⁰ argues that in the original proposal of the ECS the SE was conceived as a supranational company based upon EEC law and largely detached from domestic laws of member states. However, after long arguments, counter-arguments and much criticism of the proposal a compromise approach which includes most of national laws has been adopted. However, this is an indication that the SE has now lost its original objectives. According to De Ley:

'This compromise might be interpreted as an indication that even in EEC Community Law, it is hard to denationalise Company Law'²¹¹.

But it may be equally true that Company Law is hard to internationalise. This is because it is hard to eliminate the psychological effects of 'nationalism', and more importantly, because, whether national or supranational, "the [ESC] is like a tip of an iceberg whose greater part is submerged in an ocean of municipal law, and social and economic realities"²¹². The SE will always be rooted in the soil of a particular member country. Its law will always be interpreted and enforced by the courts and lawyers of a particular country albeit with guidance from the European Court of Justice.

As a result of these complications it is crucial for the company lawyers of Member States in the enactment, interpretation and enforcement of EEC Company Laws or Directives, to adopt an approach which takes into account the interests of 'foreigners'. This is particularly true, in matters in which interdependence makes co-operation inevitable.

5:4:2. THE AFRICAN COMPANY LAW?

Can African countries develop an African Company Law based on the example of the EEC? The answer to this question is hard to find when current developments in Africa are analysed.

One may argue that the economic conditions for such a development in Africa do not exist. This is confirmed by the current Secretary General of OAU that:

²⁰⁹Supra n. 122 para 3.57.

²¹⁰De Ly, International Business Law and Lex Mercatoria, (1992), Amsterdam: North-Holland, at p. 40.

²¹¹Ibid. at p. 40; See also Hofstetter supra n. 186, at pp. 587 - 588.

²¹²Storm, Paul M., 'Statutes of a Societas Europea', 5 C.M.L.Rev. (1967 -68), pp. 265 - 290, at p. 275; See also, Storm Paul, M. 'Companies and the Common Market' in Alders Carel A.V (Ed.), Branches and Subsidiaries in the European Common Market, (1976) (2nd. edn.), London: Kluwer-Harrap. at p. 44.

'The issue is that all along, African countries have not really focused seriously and meaningfully on the question of economic co-operation among themselves'²¹³.

Bondzi-Simpson²¹⁴ gives twelve unique and fragmented patterns of investment in Africa. These include: (i) The fact that most of the investments are those started by foreign companies during colonialism, despite the fact that Africa is the richest continent in natural resources and that most of the goods produced in the cash sector are sold abroad. (ii) Most commodities are exported in a rudimentary state. (iii) Exports are dominated by TNCs or the so called joint venture companies with local companies or government agencies, and, (iv) The TNCs have established for themselves an oligopolistic network. Consequently, African countries have not created the complementary economic opportunities, essential for economic co-operation.

An optimist may argue that the efforts to establish the African Company have already started with the establishment of the African Economic Community. The Community was established by the Treaty signed in Abuja - Nigeria on 3rd June 1991 by member states of the OAU²¹⁵. One of the major aims of the Treaty is to fulfil the "Monrovia Declaration of Commitment" which *inter-alia* calls for the creation of the African Common Market²¹⁶. However, the Community and hence the common market is to be established systematically in three stages, over a period of thirty four years²¹⁷. In the first stage (not exceeding five years) the existing sub-regions will be strengthened. During the second stage, which lasts for eight years, intra-subregional and intra-regional business tariff and non-tariff barriers will be removed. Then the third stage will be the integration of different sectors²¹⁸.

One major weakness of the Treaty is that unlike the EEC Treaty which has provisions that are the basis for the harmonisation of the Company Laws of Member States and for attempts to establish the SE, the AEC is silent on these issues. Co-ordination and harmonisation is limited to policies²¹⁹.

Since the establishment of the AEC has to begin by strengthening sub-regional economic communities, our attention is focused on the sub-regional economic integration. We limit

²¹³In the Courier No. 123 of Sept - Act, 1990, pp. 2 - 5, at p. 5; See also Munna Ndulo, *infra* n. 219, at p. 105.

²¹⁴'Transnational Corporations in Africa: A Framework for Regional Regulatory Arrangements', in Bondzi-Simpson Ebow, P. (Ed.), The Law and Economic Development in the Third World, New York: Praeger, pp. 87 - 88.

²¹⁵*Supra* n. 121.

²¹⁶*Ibid.* at p. 1251, see also Art. 4(h), at p. 1253.

²¹⁷Art. 6.

²¹⁸Art. 6 *ibid.*

²¹⁹Art. 4(d); This oversight is also noted by Ndulo Munna, 'Harmonization of Trade Law in the African Economic Community', 42 I.C.L.Q. (1993), 101, at pp. 115 - 117..

ourselves to the Southern and Eastern African Region. In particular, the Preferential Trade Area (PTA) countries. However, as a matter of comparison, the Southern African Development Co-ordination Conference (SADCC) will be discussed. This is because both institutions are established within similar geographical area, with more or less same objectives²²⁰. Our analysis also limits itself to the efforts aimed at establishing sub-regional company law²²¹.

The PTA aims at promoting the co-operation and development of Member countries in all fields of activities, including trade²²². SADCC on the contrary, was established to co-ordinate government projects in order to reduce dependency on South Africa, and promote regional integration²²³. Thus, while PTA is market oriented SADCC is geared towards a planned economy. However, despite these differences in their objectives, conflicts in their operations have been reported²²⁴. Indeed, some writers²²⁵ have noted the danger of mixing up operations and policies of the two institutions. With changes in the world economic outlook and the recent democratic changes in South Africa, the role of SADCC is likely to diminish while the role of the PTA is likely to increase. Particularly, in the co-ordination and harmonisation of the laws applicable to private business enterprises within the region.

The PTA and The Multinational Industrial Enterprise (MIE).

In an endeavour to establish a legal framework for trans-border business enterprises within the PTA, member countries adopted in 1991 a Charter for establishing a Multinational Industrial

²²⁰Much has been discussed as regards the comparison between SADCC and the PTA. See for example Mtengeti Migiro Rose, Institutional Arrangements for Economic Integration in Southern and Eastern Africa: A Study of SADCC and the PTA with Experience from the EEC, (1992), Konstanz: Hartung-Gorre Verlag; Nendengwa, P. 'Co-operation Among Sub-Saharan African Countries: An Engine of Growth', 15 Journal of Development Planning, (1985), 150; Saasa Oliver S. (Ed.), Joining the Future: Economic Integration and Co-operation in Africa, (1990), Nairobi: African Centre for Technological Studies; Blumenfeld Jesmond, Economic Interdependence in Southern Africa: From Conflict to Co-operation, (1991), London: Pinter Publishers; Maasdrop Govin and Whiteside Alan, Towards a Post-Apartheid Future: Political and Economic Relations in Southern Africa, (1992), London: Macmillan Press.

²²¹None of the above writers has discussed this important aspect. Although Mtengeti *ibid.* at p. 8 points out that the major concerns of both the SADCC and the PTA should be to develop indigenous entrepreneurship in private joint ventures, and the harmonisation of laws and policies, she later does not pursue this suggestion in her text.

²²²See Art. 3(1) of the PTA Treaty reproduced in 21 I. L. M., (1982), 479ff; SADCC was established by a Memorandum in 1981, it is reproduced in Mtengeti *ibid.* pp. 182 - 191.

²²³Mtengeti *ibid.* at pp. 47 - 49.

²²⁴*Ibid.* at p. 169; Hawkins Anthony M. 'Economic Development in SADCC Countries', in Maasdrop *supra* n. 220, at p. 121.

²²⁵For example, Mtengeti *supra* n. 220.

Enterprise (MIE)²²⁶. The establishment is based on the PTA Treaty protocol on co-operation in the field of industrial development²²⁷. In particular, article 4(1) which provides that:

'Member States agree to promote and encourage the establishment of multinational industrial enterprises in accordance with the laws in force in the Member States in which such enterprises shall be established, and having due regard to the economic conditions and priorities of a particular Member State concerned'.

Thus, unlike the EEC Company Laws, the mandate to the PTA as regards the establishment of the regional company is limited by the Treaty itself to the national laws of member states. The shortcomings of this, as far as joint venture companies are concerned, are analysed later in this study.

According to Article 6 of the Charter the MIE may be formed in one of the following ways: (a) By two or more Member States who are the parties to the Charter; (b) By one or more of the above Member States and one or more nationals of the Member States; (c) By two or more individuals from two or more Member States who are parties to the Charter; (d) By limited liability companies of at least two or more Member States who are parties to the Charter, by forming a joint subsidiary or by merging; (e) By an MIE together with another or one or more MIEs or limited liability companies of Member States, by merging or forming a joint subsidiary; (f) By an MIE or a limited liability company, together with one or more individuals of Member States; (g) By one or more Member States who are parties to the Charter, together with an existing MIE.

It seems therefore, that joint venture companies within the PTA may only be established under (d) and (e) above. However, it is interesting to note that unlike the EEC joint venture companies which may be formed only by limited liability companies, in the PTA two or more MIEs may form a joint venture company as another type of an MIE. Another interesting feature is that in the PTA the governments of Member States may form MIEs among themselves. Nothing prohibits MIEs formed this way from forming other MIE joint ventures. The implications of this will be analysed later.

Further conditions for the formation of an MIE are laid down by article 5 of the Charter. It provides *inter-alia* that in order to become eligible for the status of an MIE, an enterprise must fulfil the following: (a) The contribution of the members, who must be from different member states, should not account for less than 51 percent of the total capital; (b)&(c) No one member from one member state should contribute less than 10 or more than 80 percent of the total capital;

²²⁶Reproduced in 30 I. L. M. (1991) 696ff. According to Art. 26 of the Charter, the Charter will enter into force when it is signed and ratified by at least nine PTA Member States.

²²⁷Annex VII of the Treaty *supra* n. 222, at p. 532.

(d) The activities of the MIE should involve undertaking a special project, specified in the Charter; and, (e) The minimum capital of the MIE should be 500,000UPTA and 200,000UPTA for the MIE established in less developed member states²²⁸.

Condition (a) above implies that foreign companies (TNCs) can still participate in the MIE, provided that their capital contribution is equal to, or less than, 49 percent. In this sense, there can be a joint venture (MIE) between two PTA companies and TNCs. This is also possible if TNCs buy shares from an existing MIE since, according to article 7 of the Charter, shares may be transferred subject to article 5 above.

The internal structure of the MIE is to be determined and regulated by the national laws of the member state in which the MIE is registered²²⁹. Application for registration is to be submitted to the relevant authority of the country in which the MIE is to be registered (the country of establishment). A copy of the application has to be sent to the PTA Secretariat²³⁰. The decision whether to approve the registration or not is left to the relevant authority²³¹.

The MIE will have to enter into a 'Performance Agreement' with the government of the country of establishment, on the date when the MIE is registered²³². This agreement should specify the benefits, guarantees and obligations of the MIE and the consequences of failure on the part of MIE to adhere to the terms of the agreement.

The country of establishment is given further power to supervise the activities of MIEs located in its territory, to ensure that they comply with the provisions of the Charter²³³. In addition, the country of establishment may revoke the status of an MIE in case of non-compliance²³⁴.

In an attempt to protect the MIE and its members the Charter creates two bodies, namely the Council of Ministers and the Arbitration Tribunal²³⁵. However, the functions of these bodies are limited. The Council of Ministers for example, is only responsible for the review of the Charter and supervision in the implementation of the Charter, with a view to proposing its amendment whenever necessary²³⁶.

²²⁸UPTA is a unit currency of PTA see Art. 1 of the Charter.

²²⁹Arts. 8 & 11.

²³⁰Art. 9.

²³¹Art. 10.

²³²Art. 12.

²³³Art. 18.

²³⁴Art. 20.

²³⁵Art. 22.

²³⁶Ibid.

Disputes between the members of the MIE are to be settled amicably, or by the Tribunal appointed by the parties themselves. In the event of disagreement as to the appointment, the PTA Secretary General shall appoint the tribunal for them²³⁷. The Secretary General may also appoint a Tribunal to decide on the proper interpretation of the Charter²³⁸.

Although it is too early to assess the functioning of this rather over-ambitious piece of legislation, there is no doubt that it raises more questions than answers. One may even doubt whether it has any role to play, apart from allowing companies formed under the laws of different member states to operate freely throughout the region. The assumption that the Company Laws of member states are adequate to provide for the formation, operation, winding up and liquidation of MIEs, in a more or less similar manner, is its major weakness. The disparities in the Company Laws of different PTA Member States may be even greater than those between their economic levels of development. In most cases these laws reflect the different legal systems of their former colonial masters, both Common Law and Civil Law²³⁹. However, unlike the laws of their former colonial masters (the EEC) some of these laws have not been updated, let alone harmonised. Therefore, the danger of creating numerous MIE laws rather than one is even greater than it is in the EEC.

As far as joint venture companies are concerned, the Charter does not make specific provisions for them. The same applies to mergers. This is so despite the fact that, unlike the EEC, the PTA does not have competition laws to regulate these structures. Perhaps this is due to the general assumption that these structures are to be regulated by national laws. Examples from Tanzania in the fourth chapter show that the legal framework for these structures is also lacking in these countries²⁴⁰. Further, given the fact that companies within the PTA still lack complementarity²⁴¹, MIE joint ventures, if established within the PTA, will be established with the participation of TNCs. There are two ways in which TNCs can establish MIE joint ventures.

One method is to use the TNC subsidiaries incorporated within the laws of two or more member states of the PTA to acquire shares in the MIE. Another way is direct investment by the TNC in the MIE through holding shares which are less than 50 percent of the total contribution²⁴².

²³⁷Art. 23.

²³⁸Art. 24.

²³⁹For example, the former British colonies like Kenya, Tanzania, Uganda, Zambia, Zimbabwe, Lesotho, Botswana, Sudan follow a Common Law System. The rest which were the colonies of Portugal, France and Belgium follow the Civil Law System.

²⁴⁰See next chapter for further discussion on Tanzanian Joint Venture Law.

²⁴¹Bondzi-Simpson *supra* n. 214.

²⁴²Art. 5(1) (a) of the Charter.

TNCs can still control MIE joint ventures when they invest in them in one of the above ways. This is because the PTA Charter only seems to recognise one type of control, that is, by holding 51 percent or more of shares. We have seen elsewhere in this study that control may be exercised through means other than share-ownership²⁴³. TNCs may use this loophole to establish MIE joint ventures which they in fact control, in order to gain the advantage of operating throughout the region. This is particularly true especially when one considers the fact that the Charter does not provide for regulations, like using for example, the concept of a groups of companies to protect other parties to the MIE against the TNC.

Another shortcoming of the Charter is the potential conflict and contradiction between different enforcers of the Charter. Enforcement by the Tribunal which is the only non-national body for enforcement may cause problems. This is not only because total enforcement of arbitration tribunals may be impossible²⁴⁴, but also because of the considerable influence that national laws have in the Charter. National laws are enforced by national courts whose decisions may contradict those of the tribunal. The Charter does not indicate which decision should prevail in such situations.

Therefore, since its inception the PTA has suffered from at least one major weakness: the Treaty and therefore the PTA itself, regard law and, to a lesser extent, policy as "exogenous variables"²⁴⁵. Thus, no efforts are made to harmonise or enact laws and regulations through which trans-border business structures like joint ventures can be legally formed and operated. Perhaps the Charter for the formation of an MIE is premature. According to the Treaty²⁴⁶ it was supposed that ten years after the establishment of the PTA, efforts would be started to transform the preferential trade area into a Common Market, and eventually into an Economic Community. Efforts to harmonise the Company Laws of member states and the provision of new laws for new structures, would be initiated within the same framework. Until this is done, one thing, at least, remains clear: that joint venture companies formed within the PTA, whether as MIEs or otherwise, have to be formed according to the national laws of respective member states.

The Southern African PTA countries are not the first developing countries to attempt to establish a legal framework for cross-national joint ventures. The Association of South East Asia Nations (ASEAN) made the same attempts since 1977 when the ASEAN PTA was signed²⁴⁷. In 1983 the

²⁴³See our discussion in chapter four *supra* pp. 137 -145.

²⁴⁴See *supra* pp. 194 - 196.

²⁴⁵Peter Takiranbudde, N. 'Regional Co-operation and Trade Liberalisation: The Case of PTA', in Saasa Oliver *supra* n. 220, at p. 57.

²⁴⁶*Supra* n. 222, Art. 29.

²⁴⁷The countries involved are: Indonesia, Malaysia, Philippines, Singapore, Thailand and Brunei. The Basic Agreement on ASEAN Industrial Complementation Agreement was signed on June 18, 1981 and is reproduced

ASEAN countries established what is known as ASEAN Industrial Joint Venture Agreement (AIJV)²⁴⁸. For the purposes of comparison we make a brief analysis of the legal structure of the AIJV below.

5:4:3. THE ASEAN INDUSTRIAL JOINT VENTURE (AIJV).

The establishment of the AIJV was based on the Declaration of the ASEAN Concord signed in Bali, Indonesia on 24th February 1976. The declaration required Member countries to take co-operative action in their national and regional development programmes, utilising as far as possible the resources available to broaden the complementarity of their respective economies²⁴⁹. On 7th November 1983 the Basic Agreement on the Industrial Joint Venture was signed²⁵⁰. Under paragraph 2 of Article I of the Agreement an AIJV was established and was defined to mean an entity which:

- "(a) produces an AIJV product in any of the participating countries;
- (b) has equity participation from nationals of at least two participating countries; and
- (c) satisfies the equity ownership provisions".

The equity ownership provisions which were stipulated under paragraph 5 required that in order for an AIJV to be recognised a minimum ASEAN equity ownership of 51% was necessary. This requirement was not to apply where the participating countries agreed to a higher equity participation by non-ASEAN investors or where more than 50% of the products produced by the AIJV were exported to non-ASEAN markets. Also a 51% requirement was not required for AIJVs whose products were already being produced prior to the approval of an AIJV.

The formation of an AIJV is different from that of the MIE in the sense that in the formation of an AIJV it is the ASEAN committees, (not member countries) which give the final approval for its establishment. Prior to its formation the Committee on Industry and Energy (COIME) invites nominations from nationals (prospective AIJV members) for AIJV products. The nominations have to be accompanied by details of existing production facilities, such as, ownership and control, location and production capacities. Different nominations are listed by the COIME and the list is sent to member countries. Member countries are required to study the tentative list of

in 22 I. L. M (1983), p. 1229; For the general discussion about ASEAN economic co-operation see articles in Simmonds Kenneth R. (Ed.), Law and Practice Under the GATT and the Association of South - East Asian Nations (ASEAN), (1991), New York: Oceana Publications.

²⁴⁸Reproduced in 22 I. L. M, (1983), 1233, see Art. 1.

²⁴⁹See recital 5 of the Concord, reproduced in, Malaysia: Facts on ASEAN, (1977) Ministry of Foreign Affairs, pp. 39 - 44, at pp. 39 - 40.

²⁵⁰Note 249 supra.

the products and indicate products in which they would like to participate and declare any production facilities they have for those products. Those products for which at least two member countries have indicated their intention to participate are included in the final list of the AIJV which is submitted to the ASEAN Economic Ministers Committee (AEM) for final approval. As regards new AIJV products, interested parties are given further six months from the date of approval to obtain approval from appropriate government agencies to produce such products in member countries²⁵¹.

The co-ordination by COIME and final approval by AEM are important in order to discover complementary capacities of member countries and ensure that member countries are given opportunities to participate in the joint production. Further, according to Article III of the Agreement participating countries are required to extend a minimum margin of tariff preference of 50% for the AIJV product during the initial four year period.

However, despite these advantages, the Agreement does not specify or provide for the legal structure of an AIJV and regulation for its internal and external relations. It does not, for example, indicate the documents required for its formation, regulation of its main organs, its minimum capital and the requirement for maintenance of its business. As seen elsewhere in this study these are the factors which define the joint venture company as an enterprise. It seems therefore, as in the case of the MIE, that the legal regulations on the formation and operation of the AIJV are to be determined by the member countries in which it is established or operated.

The establishment and operation of AIJVs in such an uncertain legal environment has not been easy for the ASEAN countries. After a decade of AIJV establishment, ASEAN countries discovered obstacles to the execution of the Basic Agreement. The first problem was the 49% equity limitation on the participation of non-ASEAN investors. This was regarded as unworkable in the global economic environment of the late 1980s characterised by trade liberalisation and privatisation in most countries, including ASEAN countries. Secondly, the 1983 Basic Agreement put less emphasis on the establishment and enhancement of complementarity between nationals of member countries. As seen elsewhere in this study complementarity is essential for the establishment of true joint ventures. The absence of complementarity meant that only a limited number of AIJVs could be formed among ASEAN members²⁵². Thus, in an attempt to solve these

²⁵¹See article II *ibid*.

²⁵²According to the 1991 - 1992 annual report, since the AIJV establishment, only 21 AJVs were in various stages of implementation, only 8 AIJV small projects were approved by AEM in that year, and four major projects which involved the production of major spare-parts were dropped from the final list, arguably because of lack of complementarity (i.e, lack of at least two participating partners from different member states). See ASEAN 1991 - 1992 Annual Report, (1992) Jakarta: ASEAN Secretariat, pp. 37 -38.

problems the meeting of the ASEAN heads of government of December 1987 agreed to revise the 1983 Basic Agreement on many issues²⁵³.

The latter Agreement modified the definition of an AIJV so as to limit the mandatory equity contribution of nationals from at least two participating countries to a minimum of 5%²⁵⁴. Also according to paragraph 5 of Article I: "In respect of projects for which AIJV status has been applied before December 1990 and subsequently approved, the applicable minimum ASEAN equity ownership shall be 40 per cent". Article III was also amended by extending the minimum tariff preference to AIJV products from 50% to 90%. In addition, in the 1991 - 1992 report²⁵⁵ COIME recommended that the Agreement should be further amended so that the five percent minimum equity requirement from nationals of participating countries should be relaxed after a period of four years, and so that the limit of 40% local participation should be extended beyond 1990. These recommendations were to be considered in the 1993 meeting of heads of ASEAN governments.

ASEAN countries have also realised that TNCs cannot be ousted if complementary opportunities for the establishment of local joint ventures are not available. They have, as a result, amended their agreement to include deliberate emphasis on enhancing local complementarity in order to reduce dependence on TNCs. Article 2B of the 1992 ASEAN Framework Agreement states:

Member States agree to increase investments, industrial linkages and complementarity by adopting new and innovative measures, as well as strengthening existing arrangements in ASEAN²⁵⁶.

Countries of the Southern African PTA have much to learn from the ASEAN PTA experience, at least as far as the regulation of the participation of TNCs is concerned.

5:5. CONCLUSION.

The inquiry into the International Trade Law of cross-national joint venture companies had two major purposes: First, the analysis in the fourth chapter indicated that the laws of a single nation would seldom be adequate to regulate these structures. Second, although the joint venture company is by its very nature independent of its parents, the maintenance of its independence depends on the ability of the law to protect it from the acts of its parents which aim at controlling it. Domestic laws of the country in which that joint venture is established may not affect the

²⁵³A copy of the revised Agreement is produced in ASEAN, Meetings of the ASEAN Heads of Government, Manila, 14 - 15 December 1987, (1987), Jakarta: ASEAN Secretariat, pp. 57 - 62.

²⁵⁴See paragraph 3 of Art. I *ibid.*, at p. 58.

²⁵⁵*supra* n. 253, at p. 38.

²⁵⁶Reproduced in 31 I.L.M. (1992), 506.

foreign parent company (TNC).

International legal efforts which are based on the NIEO documents include: codes of conduct for TNCs and international arbitration rules. The analysis of these efforts reveals that there is still much to be done to make sure that elements of interdependence and co-operation between nations and cross-national enterprises are not overshadowed by national or individual interests.

Attempts to develop an international legal framework for cross-national joint venture companies are also traced to common usage and customs followed by companies when they enter into co-operative business transactions or agreements. These show that there is a slow but sure development of common rules (*lex mercatoria*) which may be applied internationally. However, lack of codification and disagreement between its proponents show that it is too early to conclude that the 'new *lex mercatoria*' will be different from the old one.

The international efforts to develop a legal framework for cross-national joint ventures were also traced to different regional efforts. The European Economic Community (EEC), the African Economic Community (AEC) and the ASEAN PTA were used as examples. Although there is still light at the end of the tunnel the analysis of the attempts by the EEC to develop a cross-national Company Law (ECS), the attempts by the Southern African PTA to establish a Multinational Enterprise Law (MIE) and the Agreement by ASEAN countries to establish an AIJV reveal that Company Law is hard to denationalise and equally hard to internationalise.

Given continuous growth in economic interdependence and trade liberalisation, the formation of cross-national joint ventures is likely to increase. Thus, whether we like it or not the development of national company law to meet the challenges of business transnationalisation faces an inevitable task of devising a legal framework for cross-national joint venture structures. For this framework to affect these structures, it should not only consider the interests of local partners but also those of foreign nationals, particularly in matters where, because of interdependence, co-operation is desirable or inevitable.

CHAPTER SIX.

A CASE STUDY OF TANZANIA.

6:1. JOINT VENTURE COMPANIES AND THE LAW IN TANZANIA.

The notion of a joint venture appeared for the first time in the *National Investment (Promotion and Protection) Act* of 1990 (NIPPA)¹. But only in the definition or interpretation section. The Act defines a joint venture as:

'An association, whether incorporated or unincorporated, between foreign investors and local co-operative or parastatal organisations, local investors and local parastatals and, or co-operative organisations, for the purposes of making an investment jointly in an enterprise in respect of which an application may be made for a certificate of approval'².

We discuss the important elements of this definition in detail below.

(i) An incorporated or unincorporated association.

This means that in Tanzania a joint venture company may take the form of either an incorporated organisation, in which case it may be understood as a joint venture company (JVC), or, an unincorporated business association like partnerships, contracts or co-operatives.

(ii) Between foreign and local investors or local investors inter-se.

This part intends to define who may be the parties to the joint venture. It gives two categories of investors, namely foreign and local investors.

Foreign Investors.

The definition does not give the meaning or the categories of the foreign investor. However, it can be deduced from the meaning of a "foreign national" as provided by the same section³.

¹Act No. 3 of 1990, GN. No. 26 Vol. 71 of 29th June 1990.

²Section 2 of the Act Ibid.

³Ibid.

A foreign national means: (a) a person who is not a citizen of the United Republic; (b) a company or other body corporate incorporated outside the United Republic; (c) a company incorporated within the United Republic in respect of which the Minister is satisfied:- (i) that the majority of the issued share capital is beneficially owned by foreign nationals within the meaning of this definition; and, (ii) that there are special reasons why the company should be treated as a foreign national for the purpose of this Act.

For the purpose of this study the definition of the foreign national only concerns us in (b) and (c) above.

(b) A company incorporated outside the United Republic.

Before the enactment of the NIPPA a company not incorporated in the United Republic could not establish a place of business in the country "unless it has applied for and obtained the approval of the registrar [of companies]"⁴. The NIPPA does not specify whether TNCs intending to invest in the joint venture company with local investors should have the same approval. The approval can only be obtained in respect of the joint venture enterprise and not the foreign company alone. Therefore, the joint venture form may be a good mechanism for foreign companies to escape the legal consequences of directly investing in the country themselves⁵.

(c) i. Where the majority issued share capital is beneficially owned by the foreign nationals.

In this case a "beneficially owned by foreign national" may include a person who is not a citizen of the United Republic or a company incorporated outside the United Republic. However, the section leaves the term "beneficially owned" too general. It may be interpreted to include local agents of foreign companies, or even foreign creditors of a local joint venture company.

ii. "Special Reasons".

The section anticipates that there can be special reasons for treating a company as a foreign national, despite the indicators of the foreign company discussed above. These reasons are not provided anywhere in the Act. As such, what amounts to special reasons remains in the mind of the Minister. This provision is too general and may not be properly understood by TNCs interested in investing in the joint venture form. It is a cumulative definition. It may also be construed to mean that a foreign owned but locally registered company will only be treated as a

⁴See Section 320A of the Tanzanian Companies Ordinance (Cap. 212) hereinafter referred to as 'the Companies Ordinance'.

⁵For example, Section 321 requires that a foreign company before it has started business in Tanzania should *inter alia*, submit the following documents: (a) a certified copy of its charter, statutes and articles of association; (b) the full address of the registered office of the company; (c) a list of the directors of the company and their particulars; (d) the names and address of the directors or any other person resident in the country.

foreign company if the Minister believes there is a special reason to do so.

2. Local Investors.

The categories of local investors are provided by the definition of the joint venture. They include: co-operative organisations, parastatal organisations and private investors.

(a) Co-operative Organisations.

According to the definition a co-operative organisation may join either a foreign investor, or, a local parastatal organisation, a local private company or another co-operative organisation to form a joint venture. These types of joint ventures are beyond the scope of this study and we shall not discuss them.

(b) Parastatal Organisations.

Parastatal Organisations can join foreign investors or other local investors to form joint ventures. Most of these joint ventures are likely to be formed under the current public sector reforms in Tanzania⁶. According to official data Tanzania has more than four hundred parastatal organisations. Out of these, about three hundred are to be privatised. Most of them by way of joint venture formation⁷.

A parastatal organisation in Tanzania is sometimes known as a public corporation. Several Acts of Parliament also define it differently⁸. Nevertheless, all the definitions tend to limit the meaning of the parastatal organisation to any business enterprise in which the government or its agent owns majority shares. While the need for the reconciliation of these definitions is noted, the definition of a parastatal organisation which is based on a number of its shares owned by the government, complicates the proper meaning of the joint venture company. Thus, for example, if a joint venture company is formed with one of its parties being the government or its agent holding 50%

⁶See our discussion in chapter two pp. 22 - 27.

⁷See the Presidential Parastatal Sector Reform Commission's Master plan, (1993), Dar es Salaam: Government Printer, pp. 15 - 21, paras 501 - 532, see also appendix 3 *infra*.

⁸For example, section 2 of the Public Corporation (Amendment Act) of 1993 defines it as: 'any corporation established under [the] Act or any other law in which the government or its agent owns majority of the shares or is a sole shareholder'; Section 2 of the NIPPA, *supra* n. 1 defines it as: 'a statutory or public corporation owned by the government or its company in which more than fifty percent of the issued share capital is beneficially owned by the government': The Tanzanian Legal Corporation Establishment Order, (GN. No. 32 of 1971) defines it as: '(1) a body corporate established by, or under any written law other than; (a) a company incorporated under the Companies Ordinance, (b) a body corporate established under any Act of the Community (now defunct), (c) a local authority; (2) any company registered under the Companies Ordinance not less than 50% of the issued share capital of which is owned by the government, a local authority, or a parastatal organisation; (2) any body of persons whether corporate or non-corporate, which is designated by the minister by notice in the gazette to be parastatal organisation.'

or more of the shares it may be referred to as a 'parastatal (joint venture) organisation'. Consequently, it may be subjected to different laws and regulations which regulate parastatal organisations. Most of these laws enable the government to interfere too much in the affairs of the company⁹.

(c) *Private Investors.*

Private investors can only include companies established within the private sector. That is, which are regulated by the Companies Ordinance (Cap.212).

(iii) *Must make an Investment Jointly.*

'Joint investment' has been included in the definition to indicate that the investment is a joint venture. However, joint investment alone as it stands, without further explanation or qualifications, does not depict some of the elements necessary for the existence of a joint venture. As discussed in the preceding chapters, for a joint venture to be formed, joint investment or contribution should come as a result of complementary objectives and inputs. Secondly, there must be shared control and joint profit/loss sharing as other indicators¹⁰. These features do not appear in the above definition.

(iv) *In an Enterprise.*

The definition refers to the body created as an enterprise, rather than involving itself in the categorisation of different joint venture structures which may be formed. This is, in a way, an acknowledgement that whatever structure or form a joint venture may take, it must be an enterprise. As seen in chapter three the idea of an enterprise means economic independence¹¹. In this sense therefore, joint venture companies established in Tanzania should be independent economic entities.

Apart from the inadequacies in the definition, the Act does not provide how different types of

⁹See for example, the Tanzania Legal Corporation Establishment Order Ibid.; Another example can be obtained from the Tanzania Railway Corporation Act, (Act No. 11 of 1977) and Tanzania Harbours Corporation Act (Act No. 12 of 1977). For example, section 13(1) of the former Act provides: 'The Minister shall be responsible for the general direction and control of the corporation and may, for the purpose: (a) give direction of a general nature to the board relating to the operation of the undertaking; (b) approve any major alterations in the tariffs, rates, fees, and other charges made for the services provided by the corporation; (c) approve any individual capital works; (d) give particular directions to the board concerning any matter involving agreement with, or interest of, any foreign country'. See also Mwapachu Juma, Management of Public Enterprises in Developing Countries, (1983), New Delhi: Oxford & IBH Publishing Co., pp. 182 - 220.

¹⁰See our discussion in chapter two pp. 28 - 31.

¹¹See our discussion chapter three supra pp. 76 - 77.

joint ventures should be formed and operated. Arguably, it assumes that the formation and operation of joint ventures are based on different laws, depending on the legal structure or form they decide to take. As far as corporate joint ventures are concerned, the previous chapters have discussed several difficulties which may arise when joint venture companies apply the Tanzanian Companies Law. The Tanzanian Companies Ordinance is rather old, it was enacted in 1932, based on the English Companies Act of 1929. Whereas the English Companies Act has undergone several constructive amendments, which as we have noted, can apply to modern business associations such as joint ventures but the Tanzanian Ordinance has not. In the part below, with the help of examples from few case studies, we discuss how different joint venture companies in Tanzania try to cope with the above deficiencies.

6:2: THE CASE STUDY OF SIX JOINT VENTURE COMPANIES IN TANZANIA¹².

The companies under study were chosen almost at random. However, the unrestricted formation of private companies has only recently been allowed in Tanzania¹³. As a result few of the joint venture companies which are currently being established with the participation of local private companies have well established offices. For these reasons the chosen joint ventures were ones in which the government or its parastatals have some stakes. The choice is nevertheless relevant to this study in order to prove whether, given the existing legal framework, the current parastatal reform policies which favour the establishment of joint ventures, has any prospects of success.

STUDY No. 1.

TANZANIA ELECTRICAL GOODS MANUFACTURING Co. Ltd.(TANELEC)¹⁴.

This joint venture company was incorporated in 1980, under the Companies Ordinance (Cap.212), as a private company. Its main objective is to produce different electrical goods. In

¹²The study was conducted in the period between February 1993 and May 1993, and between March 1994 and April 1994. This study was mainly done by: (i) questionnaires which were distributed to the management of the targeted joint venture companies and some local shareholders, see appendix 2 infra; (ii) interviews; and, (iii) analysis of different relevant documents used in the formation and operation of these joint venture companies.

¹³For example, when I was starting this research, negotiations between an Italian company (S.I.S.A.L S.p.A) and a Tanzanian company (Tanzania Sisal Authority) were being initiated for a formation of a joint venture company which will process and produce different materials from Tanzanian sisal. As sisal is one of major agricultural products of Tanzania, this venture, if formed, will present a good case study.

¹⁴The information given on this company was partially obtained from the managing director of the company. He is also the foreign shareholder's expert. Some data was obtained from an interview with the Corporation Secretary of the local shareholder (NDC). Some information was also collected from different documents of the joint venture company, such as, the constitution of the joint venture company and different agreements as they are discussed in the text. Further, some data was obtained from answers to the questionnaires given by the top management of the company.

particular, the company produces transformers, wire cables and electric cookers for the East African market.

The members of TANELEC are as follows: (i) National Development Corporation (NDC). This is a local parastatal holding organisation, established in 1969 to co-ordinate the activities of all government manufacturing companies in Tanzania. It holds 60% of the shares in the joint venture company. (ii) Tanzania Electric Supply Company Ltd. (TANESCO), also a parastatal organisation with the monopoly of supplying electricity to the whole of Tanzania. It holds 20% of the shares in TANELEC. (iii) National Industries (ABBNT) Association. This is a Norwegian company operating internationally in the business of electrical goods production. It holds 20% of the shares in TANELEC.

According to the Joint Venture Shareholders Agreement the foreign partner participates actively in almost all the affairs of the company. For instance, under the Management Services Agreement which is part of the Joint Venture Shareholders Agreement, the foreign partner supplies management services to the joint venture company. Although the agreement is renewable every five years, it has so far lasted for more than ten years. The foreign partner also supplies technical services to the joint venture company. This is in accordance with the Technical Service Agreement. Although the number of foreign technicians has been decreasing every time this agreement is re-negotiated (at the beginning of the venture there were twenty technical experts but since 1987 there are only three¹⁵), the technical know-how contributed by the foreign partner is still highly appreciated.

The foreign partner still needs the local partners' markets for its electrical goods and also for smoothening its relationship with the local government. The joint venture has also helped TANESCO in solving the problem of buying transformers and other electrical goods at higher prices from outside the country¹⁶.

Despite the fact that the management of the company is provided by the foreign partner, the local partners are adequately represented in the decision making through the Board of Directors. According to the constitution of the board every 20% shares are represented by one member. Therefore, the local partners, with 80% shares are the majority in the board. However, their power is balanced against the power of the foreign member by a clause in the Articles, which was agreed by the parties in the Joint Venture Shareholders Agreement, that any member has the right to have his views heard, and if not satisfied with the decision of the board he may veto the

¹⁵This is in accordance with the views of the corporation secretary of NDC.

¹⁶Ibid.

decision. However, this situation has never happened because the parties put the principle of mutual understanding before any conflicts that are likely to arise¹⁷.

The General Meeting which is considered as the supreme organ of the company is said to have little effect on the major decisions of the company. This is because each shareholder is represented in the Board of Directors, the organ which essentially decides on behalf of the General Meeting¹⁸.

STUDY No. 2.

*TANZANIA PORTLAND CEMENT COMPANY Ltd.*¹⁹.

Tanzania Portland Cement was established in 1959 under the Companies Ordinance (Cap. 212). The main objective of the company was to produce cement and other related materials for the local market. It was then a subsidiary company of the State Mining Corporation. The latter was a government parastatal. In 1974 Tanzania Saruji Corporation (SARUJI) was established as a holding parastatal organisation, it took over all the shares in Tanzania Portland Cement²⁰. In 1991 the company's business was in a bad shape. It needed rehabilitation and modern technology in cement production. Thus, a decision was made to sell some of the shares to foreign companies willing to rehabilitate the company and provide modern technology. In 1992 two companies, one known as SCANCEM International, a Norwegian company dealing with the business of cement production internationally, and a Swedish company (Swedfund), agreed to buy shares in Tanzania Portland Cement. Each bought 13% of the company's shares. SARUJI remained with 74% of the shares. On top of this, SCANCEM entered into both Management Service Agreement and Technical Service Agreement with the company to provide managerial skills as well as technical know-how to the company. Hence, to rehabilitate its production the company became a joint venture company, though still under the same name.

Foreign partners were assured of 20% of the whole joint venture company's returns and their market share in the region expanded considerably²¹. On the other side, the local partner solved the problem of deteriorating cement production. The government's burden of subsidising its production ended. Thus, the deal seemed profitable to all the parties.

¹⁷Ibid.

¹⁸Inferred from the Joint venture Shareholders Agreement and the constitution of the joint venture company. Although the company was hesitant to give information on its dividend policy, it seems most profits to the members accrue to the members through trading with the company.

¹⁹The data on this joint venture company was obtained from the company's constitution and other agreements of the company. Also from the interviews with the Corporation Secretary of the local shareholder (SARUJI) and the managing director of the joint venture company.

²⁰From the interview with the corporation secretary of SARUJI *ibid*.

²¹According to the answers in the questionnaire given by the management of the joint venture company.

As far as the management and decision making of the company is concerned, the local partner only retains control through the Board of Directors. It has three directors against two representing foreign shareholders. One for each shareholder. However, so far, no conflicts have been experienced between the board and other organs of the joint venture company²².

STUDY No. 3

*CMB PACKAGING TANZANIA COMPANY Ltd.*²³.

Before the establishment of this joint venture company, its activities which include the production of metal containers and other materials for packaging were being carried out by a government parastatal organisation known as Metal Box Tanzania Ltd. The latter company was incorporated in 1947, under the Companies Ordinance (Cap. 212). All its shares were later taken over by a British Company known as CMB Packaging Ltd. (CMB). However, in 1969, apparently because of the government's pressure which was the result of the Arusha Declaration nationalisation policy²⁴, CMB had to sell some of its shares to the National Development Corporation (NDC).

In the negotiation for the formation of the joint venture CMB agreed to give up its 50% shares to NDC on condition that it (CMB) should be the only provider of managerial services. CMB also required that its technology should be 'sold' to the new joint venture company²⁵. Thus, after the formation of the joint venture company CMB entered into the Management Services and Licensing Agreements with the joint venture company.

The mode of negotiation of these agreements is described by the local partner as fair. Since both parties were satisfied with what they got from the agreements²⁶. The foreign partner wanted to retain the control of metal supply, which was the main raw material to the joint venture company. It could only do so by having an upper hand in the business decision making of the joint venture company. It also wanted to have returns from its superior technology in the production of packaging materials and in the metal industry. On the other side, the local partner wanted to have a say in the operations of the metal industry, to gain foreign technology and to ensure abundant

²²According to the views of the managing director of the joint venture company.

²³References which are not specifically indicated below were obtained from the company's constitution which I got from Registrar of Companies' Office and other agreements which I obtained from the assistant corporation secretary of the local shareholder. Attempts to meet the management of the joint venture company were unsuccessful. However, I managed to interview the assistant corporation secretary of the local shareholder (NDC) on some of the issues.

²⁴The Arusha Declaration was a Government Socialist Manifesto, declared in Arusha in 1967. Its main objectives were *inter alia*, to nationalise all private foreign enterprises. Foreign companies which could not be totally nationalised were forced to form joint venture companies with government parastatal organisations. See our discussion in chapter two supra on forced joint ventures, pp. 18 - 21.

²⁵From the answers given by the assistant corporation secretary of NDC *ibid.* in an interview.

²⁶*Ibid.*

supply of metal packaging materials to local as well as foreign markets²⁷.

However, these agreements affect the structure of the joint venture company. This is because the management has greater influence in the Board of Directors²⁸. Although the Board of Directors is constituted of an equal number of members from both parties (two from each member), one foreign representative is at the same time the managing director. The other foreign representative is also the financial director²⁹. Moreover, recently, the Shareholders Agreement has been re-negotiated to increase the controlling influence of the foreign shareholder. A Supplementary Shareholders Agreement was necessary because the company's machinery had to be modernised and the structure of the company had to be rehabilitated. A greater capital contribution was needed from both shareholders. The local partners could not contribute any. The foreign company agreed to contribute the needed machinery which would be valued and capitalised for preferential shares. These shares give the foreign partner further rights in the management of the joint venture company, namely, the right to appoint the chairman of the Board of Directors who has the casting vote, and the right to appoint two more members to the Board. Shares are now divided into two classes. Class A represents the ordinary shares issued to both shareholders. Class B represents preferential redeemable shares. These shares so far have been issued only to the foreign shareholders.

Before the above changes in the Joint Venture Shareholders Agreement, the mode of share-ownership and the structure of the Board of Directors was typical of a deadlock joint venture company. It is generally accepted that this structure had not yet caused any problem, because there was "mutual understanding" in all decisions reached by the company³⁰. The re-negotiation of the Joint Venture Shareholders Agreement is an indication of efforts by the parties to try to overcome the dangers of a deadlock joint venture company. Parties accept that some important decisions could not be taken because of the fear of breaking up the joint venture company³¹.

STUDY No. 4.

*GENERAL TYRE EAST AFRICAN Ltd.*³²

²⁷This is in accordance with the view expressed by the local partner in the questionnaire.

²⁸*Ibid.*

²⁹*Ibid.*

³⁰*Ibid.*

³¹*Ibid.* However, according to the information obtained from the Presidential Parastatal Sector Reform Commission, negotiations are under way which will enable the foreign partner to have majority shares in the company.

³²Much of the data on this joint venture company was obtained from the company's constitution and the management and technical services agreements. Also I managed to conduct an interview with the corporation secretary of the local shareholder (NCI). Some data were also available from answers given in the

General Tyre East African Ltd. was incorporated in 1969 as a private company under the Companies Ordinance (Cap. 212). The main objective of the company was to manufacture tyres for the East African market. The initial subscribers were National Development Corporation (NDC) and General Tyre International Corporation. The latter is an American company, dealing with the business of production of tyres and other associated materials all over the world. NDC held 74% of the total shares while General Tyre held the remaining 26%. In 1980 National Chemical Industries Company Ltd. (NCI) was established as a holding parastatal organisation. Under the NCI Establishment Order of 1980 all the shares owned by NDC in General Tyre East African Ltd. had to be taken over by NCI.

Unlike other joint venture companies the establishment of this joint venture company did not involve the negotiation of a Joint Venture Shareholders Agreement. The joint venture company considers the Memorandum and Articles of Association as its main document (constitution)³³. The foreign partner also entered into two agreements with the joint venture company, namely, the Joint Venture Management Services Agreement and the Joint Venture Technical Services Agreement.

The foreign partner was particularly interested in entering the East African tyre market. The local partner wanted to use the joint venture company to become self-reliant in the supply of tyres to the local market³⁴.

Under the Management Agreement the foreign partner provides top management officials (the managing director, financial director and personnel director). The negotiation of both the management and technical services agreements has been described as fair, because: "the agreements were on give and take basis. Hence, each party got a better deal"³⁵. Moreover, these agreements are re-negotiated every five years.

However, it is accepted that these agreements have affected the structure and the decision making of the joint venture company. This is because they enable the foreign partner to have more say in the affairs of the company³⁶. This is so despite the fact that the foreign partner holds only 26% of the shares in the company. Nevertheless, since parties have the right to re-negotiate the agreements, they can still change the current structure if they do not agree with it. Further, according to the agreements the bearers of offices in the management and technical services have

questionnaire by the joint venture company's authority.

³³However, this is a view of a local shareholder not of the joint venture company.

³⁴Ibid.

³⁵Ibid.

³⁶Ibid.

to be changed every five years. In changing the management or technicians their achievements in benefiting the joint venture company, over and above what is required by agreements will affect the renewal of their service period³⁷.

The local partner is represented in the decision making machinery of the joint venture company through the Board of Directors. It has three directors against two from the foreign shareholder.

STUDY No. 5.

AGIP TANZANIA COMPANY Ltd³⁸.

Agip Tanzania Ltd. was established as a joint venture company in 1969. Formerly, this company was known as Agip East African Company Ltd. The latter company was a branch of Agip International S.p.A, an Italian Company dealing with oil production: refining, exploring and distributing oil in the East African region. The company became a joint venture company (i.e. Agip Tanzania Ltd.) in 1969, apparently because of the influence of the 1967 Arusha Declaration. The government, through Tanzania Petroleum Development Corporation (TPDC), acquired 50% of the shares in Agip East African Company Ltd.

After its formation, the joint venture company entered into a Management Services Agreement with the foreign partner. In the agreement the top management is provided by the foreign shareholders and the supporting management staff are locally recruited, provided suitable staff are available in the local managerial market³⁹.

The local party is represented in the decision making of the company by its members in the Board of Directors. Each party appoints four representatives to the Board of Directors. However, this board is highly influenced by the management because the Managing Director and the Finance Director are also representatives of the foreign partner to this Board. The finance director is also the secretary to the Board. With this kind of a structure, it is not surprising to find that many of the company's decisions have to be agreed in Rome before they are brought to the Board of the

³⁷According to the management and technical service agreements supra n.31.

³⁸Much of the data was obtained from the company's constitution and the management and technical services agreements available from the joint venture company's central office. I managed also to conduct an interview with the Finance Director of the company who is also the representative of the foreign shareholder to the Board of Directors and the secretary to the board. Another interview was conducted with the chief accountant, a local employee of the company who is a counter-part to the finance director. Some data was also obtained from the answers provided by the joint venture company's officials to the questionnaire.

³⁹According to the answers given in the questionnaire and the management and technical services agreements, the current top posts allocation in the joint venture company is as follows: managing director (foreign), finance director (foreign), technical advisor (foreign), Lubricant oil plant manager (foreign), lubricant oil blending plant production manager (foreign), electronic data processing manager (foreign), marketing manager (local), personnel manager (local), chief accountant (local), internal auditing manager (local), supplies and distribution manager (local), planning and safety manager (local).

joint venture company. Further, the management has to report quarterly to Rome on the position of its books of accounts and the balance sheets⁴⁰.

Although no problems have been experienced so far in the management of the company, the management is not happy with the current share structure. This is mainly because of the potential dangers of deadlock⁴¹.

Shareholders always meet once a year. This meeting is regarded as ceremonial because most of the important matters which could have been decided by the General Meeting are decided by their representatives in the Board of Directors. This helps to avoid unnecessary deadlocks.

STUDY No. 6.

THE NEW SUGAR (TANZANIA) COMPANY Ltd. (NEWSUCO)⁴².

NEWSUCO was incorporated in 1990 as a private joint venture company, under the Companies Ordinance (Cap. 212). The main objects for the company include: to carry on business as planters, growers, producers and manufacturers of, and dealers in sugar and allied products. Specifically however, NEWSUCO was established to rehabilitate and subsequently take-over the business of Kagera Sugar Company Ltd⁴³. The latter company is a subsidiary of the Sugar Development Corporation (SUDECO) which is a holding parastatal organisation, dealing with sugar production and marketing in Tanzania. The rehabilitation was urgently required by the government, because of deteriorating sugar production in the subsidiary.

In 1989 SUDECO and the Ministry of Agriculture commissioned a British company known as Booker Tate Company Ltd. to study and recommend to the Ministry how to rehabilitate the Kagera Sugar Company and its sugar estates. In its report Booker Tate recommended that a joint venture company be formed to take-over the assets of Kagera Sugar Company Ltd. And that

⁴⁰For example, our meeting for interview with the finance director was postponed twice because the foreign shareholder's central office in Rome requested him to finalise the accounts report and send it to the headquarters. Later in the interview, he admitted that he had to report quarterly to Rome.

⁴¹This is according to the views of the finance director. However, negotiations are now finalised with the government, whereby Agip will be allotted a further 30% of the shares so as to have majority power in the venture in order *inter alia* to remove the dangers of deadlock in the decision making of the company.

⁴²Much of the data on this joint venture company was obtained from the company's constitution and the joint venture shareholders agreement, together with its annexes, namely, the management and technical services agreements. In 1990 while working as a legal advisor to the Ministry of Agriculture, Livestock and Co-operatives, I had an advantage of participating in the final negotiations of the formation of the joint venture company. Interviews with the current management of the joint venture company were impossible because the company was not yet in operation, though already legally formed.

⁴³This is in accordance with the report: '*The Action Plan for the Rehabilitation of Kagera Sugar Company*', submitted by Booker Tate to the Ministry of Agriculture in 1989.

modern technology and good management services were needed to revive its production⁴⁴. Neither SUDECO nor the government was ready to provide the needed capital, technology and management. Booker Tate offered to buy shares from the company through the capitalisation of its pre-incorporation study services. It also promised to help the company in securing the sources of the remaining capital. It further agreed to provide management and technical services to NEWSUCO⁴⁵. SUDECO agreed to capitalise the assets of the Kagera Sugar Company in return for shares in the joint venture company⁴⁶.

In the negotiation of the joint venture shareholders agreement Booker Tate did not want the government to have majority shares in the joint venture company. On the other side, the government did not wish to leave a majority share-holding in the hands of a foreign company. A compromise was reached after a local private company known as Kagera Timber & Sugar Company agreed to take some shares in the joint venture company. Thus, SUDECO acquired 49% of the shares, while Booker Tate acquired 45% of the shares. The remaining shares (6%) were acquired by Kagera Timber & Sugar Company Ltd.. A provision was also included in the Shareholders Agreement that no shares would be acquired or otherwise transferred, with the effect of giving control of the joint venture company to the government⁴⁷. Shares were grouped in two classes. These classes represented:- in the case of class A, shares paid in Tanzanian shillings, and in the case of class B, shares paid in foreign convertible currency. No special rights were given to these shares, all were to rank *pari passu*.

It was agreed further that the quorum in the General Meeting should consist of a person(s) holding or representing not less than seventy five percent of the capital of the company. The quorum also had to include at least one person representing the holders of the 'A' shares and one person representing the holders of the 'B' shares⁴⁸.

The Board of Directors is structured in such a way that mutual control is maintained. The Board has five members, appointed by shareholders. Each member (shareholder) has the right to appoint at least one director. However, under the management services agreement the Managing Director is to be appointed by Booker Tate. Thus Booker Tate automatically has two representatives in the Board. The quorum of the Board is three but quorum has to include the Managing Director throughout the meeting. The Board can chose its own chairman.

⁴⁴Ibid.

⁴⁵According to the joint venture shareholders agreement and the negotiation thereto supra n.42.

⁴⁶Ibid.

⁴⁷Ibid.

⁴⁸Ibid.

6:3:. GENERAL OBSERVATIONS.

There are four interrelated characteristics in the above joint venture companies. First, their share structures indicate that almost all foreign partners own minority shares⁴⁹. This fact leads us to believe that the main contribution of foreign partners is not in share-ownership. Second, in all cases foreign partners provide managerial and technical services to the joint venture companies. This is an indication that while foreign partners' contribution is not mainly in share-ownership (capital), their contribution is mostly in managerial and technical services. However, it is only in TANELEC where there is evidence to show that technology has been transferred to the joint venture company. In this joint venture out of twenty foreign experts employed at the beginning of the venture, only three are still employed by the company, others have been phased out⁵⁰. Third, although all joint venture companies are established under the Companies Ordinance (Cap. 212), they all have supplementary agreements. In particular, the Shareholders Agreement, Management Service Agreement and Technical Service Agreement. Fourth, these agreements indicate a two tier management system of the joint venture company. While managerial skills and technical services are provided by foreign partners, all parties are represented in the Board of Directors. Therefore the Board is, by necessary inference, a *de facto* supreme organ of the joint venture company. Below we analyse the contents of these agreements in order to determine whether they affect the balance of control in the internal relationships of the joint venture companies.

6:3:1. The Joint Venture (Shareholders) Agreement.

All but one of the six joint venture companies studied above have joint venture shareholders agreements and consider them as important documents providing for the formation and regulation of the joint venture company. Members prefer the joint venture shareholders agreement to the constitution of the joint venture company (memorandum and articles of association), because: (i) It is brief. Every clause it includes is negotiated by all the members. Through this agreement members always negotiate only the important objects and articles and leave the details of the constitution to be filled in by lawyers. (ii) The joint venture shareholders agreement is flexible. It can be modified by parties at any time they wish⁵¹. (iii) The agreement enables parties to agree on

⁴⁹They hold between 13% - 50% of the shares. However, according to the ongoing enterprise restructuring programme, the government through the Presidential Parastatal Sector Reform Commission, is negotiating with foreign shareholders in three joint venture companies which were formed because of the Arusha Declaration, to restore majority share-ownership to the foreign shareholders. The share structures of TANELEC, CMB Tanzania Packaging, and Agip Tanzania Ltd. are likely to be affected. This information was obtained from officers working with the Commission.

⁵⁰See our discussion *supra* p. 226.

⁵¹Refer also to our discussion in chapter four *supra* pp. 95 - 100.

matters which cannot be included in the memorandum and articles of association. For example, loan agreements, management and technical services agreements, lease agreements, etc. (iv) It also assures foreign partners (especially those who are sceptical about the national company law) that their rights in the venture will be protected. In this sense, it is regarded as a compromise between national laws and international trade law. (v) It is a good mechanism to provide for the utilisation of an international arbitrator who is considered neutral by all parties.

For these reasons, parties ensure that the joint venture agreement prevails over the memorandum and articles of association. In fact three shareholders agreements in this study have a clause emphasising this requirement⁵².

*The Contents of the Joint Venture Shareholders Agreement*⁵³.

(i) Parties.

The parties to the joint venture company need not be limited to the prospective shareholders. Sometimes these agreements include government representatives, creditors representatives, etc. The advantage of including parties other than shareholders is that in most cases these agreements have to be approved by 'outside' parties who are interested in the joint venture. This is the why, in some instances, this agreement is simply known as a joint venture agreement, rather than the shareholders joint venture agreement.

(ii) Scope and Intent of the Agreement.

The agreement usually indicates the general and specific objectives and scope of the joint venture company. In particular, it declares the parties' intention or decision to form a joint venture company and the subsequent agreements which the joint venture company has to enter into with some of the parties. It also specifies the main objectives of the joint venture company. In most cases it contains a clause that unless the law provides otherwise, the constitution and business of the joint venture company should be conducted according to the joint venture agreement. And that in case of conflict between the constitution and the agreement the latter shall have preference⁵⁴.

⁵²NEWSUCO, TANELEC and CMB Tanzania Packaging . For example, a similar clause in the NEWSUCO Joint venture Shareholders Agreement (clause 2.3) provides: 'Notwithstanding any provisions to the contrary provided in the NEWSUCO's memorandum and articles of association, the constitution and business of NEWSUCO shall be effected in accordance with the terms of this agreement except to the extent that such term may be, or may become, unlawful'. As for the legal position on the effect of these agreements to the rights of other parties to the joint venture company see our discussion in chapter four supra pp. 95 - 100.

⁵³See also Appendix 1 on the draft of the Agreement.

⁵⁴ Note 50 supra.

(iii) The Constitution of the Joint Venture Company.

The Shareholders Agreement also specifies important clauses which should be included in the constitution of the joint venture company. The following provisions are usually considered to be important:

(a) Capital.

This clause usually specifies: the share capital of the company, the classification of shares; and, provisions on the transfer of shares.

The study has discovered that shares are usually classified according to one of the following methods: (i) according to the currency of contribution. That is, in local or foreign convertible currency; (ii) in some joint ventures shares are classified according to the mode of contribution. That is, in cash or in kind. However, all methods of share classification have the effect of creating only two classes, namely, foreign shareholders and local shareholders.

As regards the transfer of shares, shares are to be transferred subject to the pre-emptive clause which is specifically included in the agreement. Transfers of shares which have the effect of giving one class control over the joint venture company are prohibited.

(b) Directors.

Each shareholder is given power to appoint a certain number of directors. Usually this number corresponds to the proportion of shares that shareholder owns in the joint venture company. However, this is subject to the provision that each member should appoint at least one member, and that the quorum and each decision of the Board should include at least the vote of one representative of the class or shareholder, as the case may be. It is further indicated that the day-to-day activities of the company should be ran according to the management service agreement.

(c) Subscription and Allotment of Shares.

This clause specifies how shares should be allotted to the members of each class. Shares are usually issued on either a 50-50 basis or on some other basis that ensure that a majority of shares is not issued to one member. If one class of shares or one member does hold a majority of shares a provision is included to make sure that the majority shareholder cannot decide on all matters relating to the joint venture company considered by the General meeting.

The mode of subscription for shares is also specified in the agreement. For example, the number of shares which are to be paid for in cash and the number to be paid for in kind is indicated.

(d) General Meeting.

A provision which has the effect of making all shareholders participate in the decision making of the company through the General meeting is always included in the shareholders agreement. Some agreements require that all decisions should be reached unanimously. Some lay down that no decision will be valid unless it includes the consenting vote of at least one member from each class. Some agreements increase the percentage of shares required to pass even an ordinary resolution above that owned by the majority shareholder. For example, in the joint venture company with the majority shareholder holding 49% of the shares, the required percentage for an individual shareholder to pass a unilateral decision may be increased to 75%⁵⁵.

(iv) Ancillary Agreements.

The Shareholders Agreement also specifies the most important agreements which the joint venture company has to enter into, after its formation. These include the management and technical services agreements. In fact these agreements are negotiated simultaneously with the shareholders agreement and are made part of it. Their contents are discussed shortly.

(v) Conditions Precedent.

This clause specifies the obligations which each party has to fulfil before the company is formed. These include: obtaining a government approval, processing the acquisition of title deeds, etc., usually done by local partners. Sometimes it may involve looking for external markets and foreign sources of capital. This is usually done by foreign partners.

(vi) Applicable Law and Arbitration.

Under this clause the law which governs the agreement is specified. All of the agreements studied above provide that the law which governs them will be the law of Tanzania.

In situations where disputes between the parties cannot be resolved amicably a clause is included which provides that they should be referred to arbitration. The procedure for selecting an arbitrator in these agreements is similar to that found in the UNCITRAL Model Law Rules⁵⁶. Each partner appoints one arbitrator and the appointed arbitrators appoint one neutral arbitrator

⁵⁵See our discussion on the constitution of NEWSUCO supra pp. 232 - 233 see also our discussion in chapter four on avoiding deadlocks, supra pp. 113 - 116. Alternatively, the number of shares necessary to block majority decision may be provided, see for example case study number 4 in where 26% of share owned by General Tyre International are considered enough to block the majority decision, supra pp. 229 - 231.

⁵⁶Reproduced in 15 I.L.M (1976), pp. 701ff, section II, Articles 6 - 8, specifically, article 7; See also our discussion in chapter five supra pp. 194 - 196.

who acts as the chairman. Rules of procedure for arbitration adopted by all agreements are those of the International Chamber of Commerce (ICC)⁵⁷.

(vii) Re-negotiation clause.

The Shareholders Agreement always specifies the period after which the agreement is to be re-negotiated. In all agreements under consideration this period was limited to five years.

(vii) Termination.

A clause is also included in the shareholders agreement indicating situations in which the agreement, and hence the joint venture company, may be terminated. These include: (a) if either of the parties commits any fundamental breach of the agreement; (b) if either of the parties is insolvent and is in the process of being wound up; (c) if either of the parties is acquired or amalgamates with other companies; and, (d) if for any reason (other than those provided in the agreement) either party ceases to be a shareholder in the joint venture company.

6:3:2. The Management Services Agreements.

In all the joint venture companies studied, it is the foreign partner who provides managerial services. The terms and conditions for the provision of managerial skills are always negotiated by the parties to the shareholders agreement. A provision is also included in this agreement that after its formation the joint venture company should enter into the management service agreement with the foreign partner. In most cases the management services agreement is considered to be part of, or an annex to, the joint venture shareholders agreement. The management service agreement is important to both local and foreign parties. On the side of the local partner(s) it assures it of advanced management skills, which is one of the reasons for the formation of the joint venture company with the participation of the foreign partner(s) (TNCs). Yet on the side of the foreign partner(s) it assures it of having an upper hand in the running the day-to-day activities of the joint venture company and full participation in the formulation of its policies, regardless the number of shares it holds in the joint venture company.

The Contents of the Management Services Agreement.

⁵⁷Its headquarters are in France. However, in the agreements parties may agree on different country and town where the tribunal should be conducted. For example, in the agreements under study Geneva- Switzerland, London - England and Paris - France are the favourite. Parties may also adopt other rules of procedure, some are discussed in chapter five supra pp. 194 - 196.

(i) Parties.

The parties to this agreement are always the joint venture company and the foreign partner.

(ii) Scope of the Agreement.

This clause always indicates the parties' commitment to the agreement. In particular, the commitment of the foreign partner that it has agreed to furnish managerial skills to the joint venture company during the tenure of the agreement. Under this clause key officers and their terms of reference are provided. Key officers may include: managing director, finance director and personnel director. Terms of reference may include: devising and maintaining an effective cost control system; and, ensuring a system of production control in terms of quantity and quality which matches the demands of the market.

The provider of managerial skills is also required to prepare annual or sometimes half year reports and furnish such reports to the company's Board of Directors, as the Board may consider desirable, or as it may from time to time require.

(iii) Manpower and Personnel Training.

Under this clause the foreign partner is *inter alia* required to furnish the joint venture company with full particulars (including CVs) of the persons from its company to be seconded to the company, and guarantees of their competence.

A provision is also made under this clause requiring the foreign partner to organise a training programme of local (Tanzanian) personnel, who act as counter-parts to the foreign officers.

(iv) Secrecy/Confidentiality.

A clause is always included in this agreement which ensures that the joint venture company's information is kept secret by the foreign partner. Some agreements specify the period during which the information is to be kept secret (usually five years).

Upon termination of the agreement the foreign partner is required to deliver to the joint venture company all the information on the company's business and plans which was under its possession or control.

(v) Remuneration.

In consideration of the managerial services rendered by the foreign partner the joint venture company is required by the agreement to pay fees to the foreign partner. These fees are always calculated according to: (a) A part of the net sales of the company during the period of the

agreement. The rate of this kind of fee is usually between 1% - 3% of net sales. (b) A part of the annual net profits (usually between 5% - 10% of the profits). Both kinds of fee are paid annually.

Before payment, salaries of foreign personnel which are paid in local currency by the company are always deducted from these fees. Further, the payments are subject to the Tanzanian Tax Laws.

(vi) Term (duration) of the Agreement.

It has been a convention that management agreements in Tanzania last for a period of five years. However, some agreements include a provision for the re-negotiation of the agreements.

(vii) Miscellaneous.

Other provisions of the management agreement, for example, the governing law, arbitration and termination of the agreement are like those in the Joint Venture Shareholders Agreement, discussed above.

6:3:3. The Technical Services Agreement.

The Technical Service Agreement like the Management Service Agreement is always negotiated as a part of the Shareholders Joint Venture Agreement. It is always the foreign partner who contracts with the joint venture company to provide technical know-how and technology to the joint venture company. The local partner(s) benefits from this agreement in the sense that acquiring technology and technical know-how is one of the main reasons for the establishment of the joint venture company with foreign companies participation. The foreign partner(s) also benefits from the agreement in various ways. First, it secures a market for its machinery. Second, it creates jobs for its experts. Third, it benefits from the fees paid to it in consideration of its services. Fourth, where the agreement involves (as it always does) the granting of patent rights to the joint venture company, the foreign company also benefits from licensing royalties.

Contents of the Technical Services Agreement.

(i) Parties.

Although in the joint venture companies under study the foreign partner who provides managerial skills also provides technical services, it is not necessarily the case that the company which provides managerial skills provides technical services. Indeed, even in the cases under study, management services were not provided by the same persons as technical services. Further, although Technical Services Agreements require technicians to co-ordinate their work with the

management, their work is totally independent of the management influence. According to the agreements technicians are required to report directly to the Board of Directors of the joint venture company. Further, the fees paid by the joint venture company in consideration of the two types of agreements are different.

(ii) Scope of the Agreement.

Under this clause the agreement always specifies the project to be undertaken by the foreign partner. It also requires the foreign partner to provide particulars of experts needed (including their CVs). Technical experts may include: the chief engineer, the project manager and the plant manager.

The clause also specifies the stages which the foreign partner has to observe in performing the project. The foreign partner is required under this clause to report its progress in executing the agreement to the Board of Directors of the joint venture company - normally at the end of each stage.

(iii) Training.

A clause is always included in the agreement to ensure that the foreign partner draws up and implements a training programme for local employees (counter-parts). This may include on-job training at the plants of the joint venture company or at the overseas plants of the foreign partner. Sometimes local employees are sent abroad for specific studies under this programme.

(iv) Confidentiality.

The Technical Services Agreement also contains a clause which ensures that local partners or local employees do not disclose technical information provided by the foreign partner. The clause is also strengthened, in some cases, with the Licensing Agreement which the foreign company enters into with the joint venture company as a part of the technical services programme.

(iv) Remuneration.

The formula for the calculation of the fees payable to the foreign company as a consideration for technical services is the same as the one used in the management services agreement as discussed above.

(v) Duration of the agreement.

The duration of the agreement differs from one joint venture to another. In some agreements it ends at the end of the project. In some agreements it ends after a specified period, usually five years. This is normally after local counter-parts have been trained, ready for taking over the

activities of the foreign experts. In some agreements experts are phased out as their value to the joint venture company diminishes.

(vi) Supplementary Agreements.

The Technical Services Agreement is always supplemented with other agreements such as the licensing agreement which grants patent rights belonging to the foreign partner to the joint venture company. There may also be machinery procurement agreements between the joint venture company and the foreign company. Fees or royalties charged on these agreements differ from the Technical Services Agreement fees.

(vii) Miscellaneous.

Other provisions on the governing law of the Technical Services Agreement and for arbitration follow the pattern of the Joint Venture Shareholders Agreement as discussed above.

6:3. CONCLUSION.

The formation and operation of different joint venture companies in Tanzania follows, to a certain extent, a similar pattern. They depend very much on what parties want to achieve from using the joint venture mechanism. For the same reason, and because of the inadequacies in the Companies Ordinance, parties enter into separate agreements which provide mutual rights and obligations over and above those to be found in the Companies Ordinance. This is an indication that a legal framework for the formation and operation of joint venture companies in Tanzania may be achieved by extending the Company Law to include elements which appear in these agreements.

Some elements which appear in these agreements can easily be included in the Company Ordinance. For example, provisions which protect minority shareholders' rights⁵⁸. Again, provisions which allow the amendment of the company's constitution and prohibit management and technical services agreements which have no provisions for re-negotiation or renewal within a specified period, may help in maintaining joint control and interdependence in the joint venture company⁵⁹. The relationship between different organs within the joint venture company might be recognised in the company law statutes, if the Companies Ordinance adopted a management system, which differentiated the functions and duties of directors employed by the company for their managerial skills (executive directors) or from those of the non-executive directors who

⁵⁸See our discussion in chapter four supra pp 119 - 122.

⁵⁹See our discussion in chapter four supra pp. 129 - 131.

represent and protect the interests of the various constituencies of the joint venture company⁶⁰. Further, provisions which require mandatory independent valuation of parties' non-cash contributions may help in protecting the joint venture company's business⁶¹. We have seen in the fourth chapter that these provisions are now part of the English Companies Act. Tanzania, which is zealous in forming joint venture companies, should consider amending her Company Law to include these provisions.

It may be argued that the agreements studied above serve the same function as the Company Acts and uphold the principles of freedom of contract and free enterprise. However, it is equally important to consider the possibility that some parties may not be sufficiently informed *ex-ante* to be able to include all the necessary provisions in these agreements. For example, in the agreements studied above, none of the agreements has a provision or a specific procedure on the valuation of contributions in kind, despite the fact that this provision does not appear in the Tanzanian Companies Ordinance and is important for the maintenance of the joint venture company's business⁶². Further, some agreements do not have provisions on the re-negotiation of the agreements. In some agreements the re-negotiation periods differ. The modification of the Companies Ordinance to include these provisions may not only help to maintain uniformity in the formation and operation of joint venture companies in Tanzania, but may also protect the interests of local participants who are relatively less informed when compared to their TNCs counter-parts.

⁶⁰Whether by using a two-tier or a single-tier board system, see our discussion *ibid.* pp. 124 - 127.

⁶¹*Ibid.* pp 148 - 156.

⁶²See our discussion in chapter four *supra*.

CHAPTER SEVEN.

CONCLUSIONS.

The study attempted to determine the legal framework for the formation and operation of joint venture companies in developing countries. Research of this kind has been necessitated by the increase in the formation of joint venture companies in developing countries as a result of changes in the world economy which took place towards the end of 1980s. The changes have increased global economic interdependence and prompted the establishment of co-operative business ventures between companies from developing countries and TNCs.

Because of the joint venture company's special co-operative characteristics or elements, studies in the Anglo-American legal system tend to regard it as something alien to company law, but similar to a partnership. This has made the determination of the joint venture company's legal position in company law difficult.

Problems of accommodating the joint venture corporate structure in company law are partially occasioned by corporate legal theory. This is so especially when the analysis of the joint venture company is based on the entity and aggregate of contracts theories. These theories, being individualistic in nature, pay little attention to the fact that relationships in the corporation involve co-operative means, necessary for the achievement of members' interests. Therefore, a theory which explains why and how individuals or companies in pursuing their interests find themselves in co-operative structures such as joint ventures is necessary in order to fit joint venture companies into the company legal framework.

Contemporary developments in corporate theory single out interdependence as the main factor forcing individual traders or companies to use co-operative structures as a means of furthering their interests. The corporation is regarded as a legal structure or vehicle representing long-term agreements which are continuously negotiated between interdependent factions.

Joint venture partners adopt the corporate legal structure because they believe that the law surrounding it will be more efficient than other legal frameworks in enabling them to maintain their complementary interests, profit sharing and joint control. This means that in order to reflect these elements, company law should not favour the interests of some members at the expense of

others but should create a framework whereby the interdependent goals of the parties are achieved together and conflicts of interests are minimised.

To protect the interests of all actors in the joint venture company, it must be established not only as a legal entity, but also as an economically independent entity. The two factors needed for the formation of an economically independent entity, are: a well balanced legal framework of interests, and a sound business. These two factors are the basis of establishing a business structure as an enterprise.

The formation of the joint venture company as a legal entity but not as an economically independent entity, makes it dependent on a dominant company, the group of companies of which it is a part. Strictly speaking, this should not be regarded as a true joint venture, but as a subsidiary company of the controlling company. This is because the dominance or control of one partner over the others jeopardises the co-operative elements essential for the joint venture company, particularly the element of joint control. This important finding leads to the conclusion that the company law and doctrines which will best accommodate the joint venture company phenomenon will be those which reflect the "enterprise" principle.

A well balanced legal framework of interests in the company must include the protection of shareholders' interests, management interests and employees' interests. For this reason the present study questions the effectiveness of theories and doctrines in company law which favour only the interests of shareholders. An explanation is needed for why other joint venture company's members such as employees or managers whose contributions are crucial to the existence of the company should acquire shares in order to protect their interests as employees or managers. Nevertheless, a comparative analysis of both the Tanzanian Company Law and the English Company Law reveals that unlike the Tanzanian Company Law, the English Company Law has started to include some provisions which take account of the interests of constituencies other than shareholders. Section 309 of the English Companies Act (1985) which requires and permits the management of the company to consider the interests of employees and shareholders is a step towards a comprehensive regulation of the internal negotiations in the joint venture company. Since their contributions are complementary, the employees of the joint venture company, who contribute technical know-how or labour, the managers who contribute managerial skills, and the shareholders who contribute the company's capital assets should have equal protection. The crucial role of each group in ensuring the joint venture company's survival as an enterprise should be recognised and protected by company law.

As far as the regulation of shareholders relationships is concerned, English Company Law has started to move away from the principle of the rule in *Foss V Harbottle*¹ to a more flexible approach. This seeks to protect not only the interests of the majority shareholders but also the interests of all shareholders, whether majority or minority. Sections 459 - 461 of the Companies Act (1985) give a right to any member to take a court action whenever the affairs of the company are run in a manner prejudicial to its interests. Prior to the establishment of these provisions, and indeed in countries such as Tanzania which have not yet established such a legal mechanism for minority shareholders protection, partners in a joint venture company are likely to establish 50 - 50 share-ownership, as the only legal mechanism for the protection of minority or weaker members. The 50 - 50 joint venture company, apart from providing a recipe for the deadlock, and, hence for a premature termination of the joint venture company, may not reflect true joint ownership or even joint control. Joint venture partners who operate in countries which do not provide adequate protection for minority shareholders are likely to use shareholders agreements with provisions to protect minority interests as a supplement to company law².

Although Company Law has general provisions on the regulation of the management of the company, in order to enable it regulate the management of the joint venture company it is important to have a legal framework which makes a distinction between managers who join the company because of their managerial skills and those who join in order to protect or represent the interests of other constituencies such as shareholders and employees. The distinction is important to enable local companies to participate in the decision making in joint venture companies formed in developing countries whereby management is exclusively provided by the foreign partner (TNC), as its main contribution to the venture.

Proposals have been made in English Company Law to establish a model which separates the functions, rights and duties of executive directors from those of non-executive directors³. However, these proposals fall short of recognising the structure which represents the interests of all constituencies of the company. The adoption of the 5th EEC Company Law Directive may assist in this endeavour. This Directive proposes *inter alia* the establishment of either: a two tier management system, whereby two boards will be established, one representing all the constituencies (the supervisory board), and the other representing the management; or a single tier

¹(1842) 2 Hare 461.

²Herzfeld Edgar, *Joint Ventures*, (1983), Bristol: Jordan and Sons, pp. 41 - 63. In most cases these agreements will include provisions which require unanimous decisions in the board and in the general meeting. These also may lead to a deadlock situation if not well drafted, or if more provisions which have the effect of avoiding the deadlock are not included. The analysis of these agreements has been made in chapter six *supra*.

³Adrian Cadbury Committee Report, *The Financial Aspects of Corporate Governance*, (1992), London: Burgess Science Press.

board system whereby the interests of all constituencies are represented⁴. Unless a legal structure is devised whereby all the internal interests of the company are allowed to participate in the major decision making which affects the affairs of the company, the operation of the joint venture company, and indeed, of other modern closely held corporations, will be managed outside the ambit of company law. In such situations the formation of supplementary agreements, such as the technical and management services agreements to regulate the relationships of these constituencies must be anticipated.

The lack of a comprehensive management structure makes it impossible for company law to impose fiduciary duties on those who actually participate in the decision making of the company, whether employees, shareholders, or managers. Concepts such as "*shadow directors*" may assist in reaching the eventual aim of establishing a general fiduciary duty to a limited extent⁵.

Further, the establishment of a management structure which represents the interests of all constituencies may accommodate the notion of joint control which is essential for the existence of the joint venture company. In other words, the recognition of the fact that each constituency in the company has a substantial contribution and an important role to play in maintaining the efficiency of the company will give an adequate answer on who controls and who owns the company. This will in turn put the element of joint control, which is central to the joint venture company, into a company law perspective. While the old belief that it is the shareholders who own and control the company has been challenged since Berle and Means' controversial revelations, the issue of corporate control remains unresolved. Our study has discovered that the debate on corporate control has now entered a new chapter. This is so especially when one considers the increasing importance given to the Berle and Means' insight that control is something apart from ownership (shareholders) on one side, and from management, on the other. Its interpretation indicates that control of the company may lie in the management, shareholders or employees, depending on who needs the attributes (property) of the other most. This is because unlike the 19th century corporate membership which could be obtained only through the contribution of capital, the 'atom of property' of the 20th century has been split. The split has revealed that property may include intangible things like managerial skills, technical know-how, copyright and

⁴However, other alternatives such as workers councils or other employees representatives whose powers and rights are provided and respected by the law may be considered.

⁵This is because the concept of shadow directors applies only to those directions which are given not in the professional capacity. Moreover, although it may apply to parent companies in a group of companies, when it is applied to cross-national groups or joint venture companies it may as well suffer from the problems of extra territoriality.

even goodwill⁶. This has prompted a conclusion that in a modern company there is no one locus of control (power), and the loci of control may vary in importance by type of actions of those who exercise it. In a situation where the actions of the actors are interdependent, as is always the case in the joint venture company, the exercise of control by one actor influences and is constrained by that of other actors. Surely this explains the existence of the element of joint control in the joint venture company. It also makes the establishment of a comprehensive law of fiduciary duty indispensable, especially after *Prudential Assurance Company Ltd. V Newman Industries Ltd.*⁷

It is hoped that a well balanced legal framework of interests in the joint venture company will enable the company to maintain a sound business and thereby continue to exist as an enterprise. However, further legal regulation is necessary for the maintenance of the joint venture company's business. For example, as a large part of the share capital of the joint venture company is likely to be paid for in kind, compulsory and independent valuation of assets transferred by partners to the joint venture company, whether in payment for equities or through business transactions with the joint venture company, is necessary.

The only available general tool for ensuring the establishment of companies with a sound business base is the doctrine of lifting the veil of incorporation. This has its own limitations. Firstly, in order to balance it with the benefits of limited liability it is regarded as an exception to the general rule in most countries, including UK and Tanzania⁸. Therefore, it may be difficult to use it in cases where the joint venture company is under-capitalised because of, *inter alia*, the over-valuation of its assets at the time of formation or during business transactions between the joint venture company and its members. This will inevitably lead to the premature termination of the joint venture company.

Secondly, even if the doctrine of lifting the veil of incorporation were not an exception to the general rule and a general fiduciary duty were established, it would still be difficult to apply these principles to foreign parent companies. The major problem is extra-territoriality⁹. Unless the company law of the countries of origin of parent companies and those applicable to joint venture companies are either harmonised or elements of a unitary legal framework are established, the

⁶Section 99(1) of the English Companies Act, 1985, which provides that allotted shares and any premium over their nominal value may be paid up in money or money's worth, including goodwill and know-how confirms this conclusion.

⁷[1981] Ch. 257, the arguments by Vinelott J.

⁸See *Adams and other V Cape Industries PLC and another*, [1990] Ch. 433, and cases cited therein.

⁹Blumberg Phillip, *The Multinational Challenge to Corporation Law*, (1993), New York: Oxford University Press; UN, *World Investment Report: Transnational Corporation and Integrated International Production*, (1993) New York: United Nations Press, pp. 196 - 201.

problem of extra-territoriality will continue to ensure that the laws governing the formation and operation of cross-national joint venture companies remain wanting.

Like national laws, international efforts to harmonise or establish a unitary system for cross-national joint venture companies, must take account of the co-operative elements necessary for the formation of joint venture companies. In this context the notion of co-operation has to be widened to include international or inter-governmental efforts.

As far as cross-national joint venture companies formed in developing countries are concerned, the establishment of common transnational company regulations to cater for cross-national joint ventures, was first raised in documents connected with the establishment of the new international economic order (NIEO), the GATT and the EEC - ACP negotiations. Although the negotiations and the documents indicate a gradual movement from the confrontation of the 1970s to a more co-operative approach, there is still a great deal to be done to accommodate the regulation of cross-national joint venture companies in developing countries. It has to be acknowledged, as a starting point, that TNCs are more economically powerful than local companies. This means that although joint venture companies between TNCs and companies from developing countries will continue to be formed because of interdependence, more specific provisions are needed to protect weaker partners and control stronger ones (TNCs), and to ensure that the latter do not drive the former into a dominant-dependant relationship.

The specific proposed UN international regulations on the relationships between TNCs and local companies are mainly in the form of Codes of Conduct. The analysis of the drafts of these Codes reveal that they establish several obligations on TNCs such as: respect for the national laws, non-interference in the affairs of host countries, and, a duty of disclosure to host governments. However, these codes also suffer from several weaknesses.

The first weakness is the fact that they leave almost all aspects of the regulation of TNCs to the national laws of host countries, regardless whether such laws are appropriate or adequate. The codes do not consider whether the national laws of different countries should be harmonised to have more or less the same effect on TNCs. The superficial impression one gets from this arrangement is that, subject to the protection of TNCs' interests against nationalisation, the codes leave TNCs at the mercy of host countries. Therefore, one would be tempted to conclude that the interests of local companies are likely to be favoured over or better protected than those of TNCs. However, this conclusion may be revised when one considers that the unharmonised nature of the national company law systems allows TNCs to use their economic might and their pseudo-existence in several countries to escape legal liability in one particular country.

These Codes do not emphasise the need for TNCs to operate their subsidiaries or indeed the joint venture companies in which they are parties, as enterprises. This means that the notion of national treatment leaves a lot to be desired. TNCs should be required to establish economically independent enterprises in host countries, so that if they fail to do so host countries can regard their dependent subsidiaries or joint ventures as parts of the TNC group of companies. In the absence of such a provision, host countries will be justified in treating the interests of TNCs and those of local companies on an unequal or discriminatory basis. These problems prevent the codes from solving the problem of extra-territoriality and cast doubts on the over all effectiveness of the codes of conduct.

It is because of the weaknesses in the codes of conduct that other international developments in the regulation of the relationships between TNCs and companies from host countries have been suggested. These include the development of *lex mercatoria* and rules of international arbitration. However, the so called *lex mercatoria* is still in its initial stage of development and, because it lacks both codification and internationally accepted enforcement machinery, it is too early to assess its usefulness to cross-national joint venture companies. Further research into the effectiveness of international rules of arbitration and international arbitration tribunals in enforcing *lex-mercatoria* is needed.

More promising efforts in the development of the international legal framework for cross-national joint venture companies are being undertaken at the regional level. A comparative analysis of the draft of the European Company Statute, the PTA Convention for the establishment of the Multinational Industrial Enterprise in Eastern, Central and Southern African countries and the ASEAN IAJV Agreement has proved how difficult it is to 'denationalise' or 'internationalise' national company laws. Nevertheless, although these proposals are saturated with national law influence, the European Company Statute which is being developed in tandem with the harmonisation of the company laws of member countries, may be better equipped on its completion to regulate cross-national business structures such as joint venture companies. This is because the harmonisation of national laws creates greater homogeneity in the law across the region and this may contribute to the growth, acceptability and applicability of regional company law in member countries.

The conclusion from both UN and regional efforts in the development of an international legal framework for cross-national joint venture companies is that the modification of national company laws to accommodate joint venture companies is as important as the development of a cross-national company law. Therefore, while the legal framework for joint venture companies is mainly

determined by national company law, for it to be able to face the challenges of global economic interdependence, it should be developed through international and regional co-operation and consultation.

The Tanzania Company Law and the Way Forward.

The recent report on the privatisation progress in Tanzania indicates that out of 344 parastatal organisations already selected for privatisation more than 50% (i.e., 160) are to be privatised through the establishment of joint venture companies¹⁰. The report also recognises that because of lack of local managerial skills and technical know-how, the government, through the Presidential Commission for Public Sector Reform, is looking for, negotiating or has already formed joint venture companies with the participation of foreign companies (TNCs). Therefore, most of the findings and conclusions made in this study are relevant to Tanzania, just as they may be to any developing country which has liberalised its economy recently and which is pursuing privatisation programmes. However, although the joint venture is a novel phenomenon in developing countries, it is generally assumed that it can be formed and operated through a 19th century company legal framework. A good example of this law is the Tanzanian Companies Ordinance which was enacted in 1932 following the English Companies Act of 1929.

This study has shown that while most provisions in this Ordinance are still based on the 19th century individualistic principles, the joint venture company should be based on co-operative principles between its actors. Therefore, if the government is determined that 'proper' joint ventures should be formed under the Companies Ordinance, it requires an amendment to include co-operative principles. Urgent reforms include:

(i) Provision for flexibility in the alteration of the constitution of the company.

As indicated in this research, flexibility in the alteration of the constitution will reduce the possibility of drafting the memorandum of association in a very broad manner to cover future acts of the joint venture company. Absence of flexibility in the alteration of the memorandum of association results in the distortion of specific objectives, necessary for the formation of a true joint venture company. Although shareholders' agreements may be used to supplement the

¹⁰See Table 6.2 of the Master plan by the Presidential Parastatal Sector Reform Commission, March 1993, Dar es Salaam, appended to this study as appendix 3.

constitution, it is uncertain whether they can be registered as part of the constitution¹¹. Further, their enforceability against the company is not clear. Therefore, the current *de jure* formation of the joint venture company in Tanzania does not correspond to its *de facto* establishment.

(ii) Reform of the Ultra-vires Doctrine.

Another company law principle which prevents specificity in the constitution of the joint venture company is the classical application of the *ultra-vires* doctrine. While the formation and operation of the joint venture company is based on negotiation between different company actors, the Tanzanian company law still applies the classical doctrine of *ultra vires*. Reform is necessary as restricting joint venture negotiations to the initial agreement in the memorandum of association may be a disadvantage to the parties whose *ex-ante* bargaining power is weak because of asymmetrical information. This is likely to be the case with Tanzanian participants who initially lack managerial skills and technical know-how.

(iii) Protection of "Minority" Shareholders.

In Tanzania members of the joint venture company may protect their mutual interests by including "*Bushell V Faith* clauses" in the constitution or shareholders' agreement. However, this may not be enough. The nature of the joint venture makes these clauses result in a deadlock. The introduction of legal provisions which protect the interests of all actors may help to remove the deadlock or to terminate the joint venture company only when it is in the interests of all members to do so.

(iv) Reforming the Management Structure.

A good number of joint venture companies in Tanzania is likely to be formed with the participation of TNCs as the providers of managerial skills. This requires a management structure whereby local interests of shareholders and employees are represented in the major decision making of the company, at the same time without interfering with the day-to-day management activity of the company. As seen in this study, this can be achieved by adopting a management model whereby the role of executive directors is separated from that of directors who represent the interests of other constituencies.

¹¹ Mercer Colin, "Does a Shareholders' Agreement Require Filing with the Registrar of Companies?", *15 Co. Law* (1994) 19 - 21, suggests that because shareholders agreements are common in joint venture companies, they should be compulsory registered with companies registrar.

(v) Maintaining a sound business in the Joint Venture Company.

True joint venture companies can be formed only if there are provisions which ensure that the contribution by the parties corresponds to the share capital as indicated in the constitution of the company. As the contributions of the members to the joint venture company are likely to be mainly in kind, it is necessary to have a legal requirement recognising this and ensuring that the value of contributions corresponds to the value of the issued shares. This may *inter alia* specify the maximum amount of capital to be contributed in kind and the period within which such contribution should be transferred to the joint venture company. It may also be required that the contribution should be valued by an independent valuer before the expiry of that period.

(vi) Reform in the general concept of Control.

The above recommended reforms aim at ensuring that the company is formed as an enterprise. Therefore, it may be important for the Tanzanian company law to emphasise this requirement. This may be effected through the requirement that companies should be formed as economically independent entities. The law should also introduce a means for enforcing this requirement and a remedy for the affected party, in case of breach. To this effect, the definition of control, especially between a parent company and a subsidiary company or a dominant and a controlled company need revision to include other methods of control such as controlling contracts and controlling influence.

(vii) Involvement in the International or Regional Regulations.

Some of the recommended reforms may be difficult to implement. This is because their proper implementation may conflict with the laws of other countries in which other parts of the TNC are formed and operated. Hence, the problem of extra-territoriality. As seen from this study the problem of extra-territoriality can be solved through co-operative efforts by the countries concerned. These efforts should be geared to harmonising and/or developing some common elements of company law with general or similar applications to cross-national joint ventures. This can be done internationally under the UN and regionally, under different regional economic organisations. Tanzania being a member of the United Nations (UN), the Organisation for African Unity (OAU) and the Eastern, Central and Southern Africa PTA has a role to play in influencing these changes, mostly however, at the regional level. The study of the MIE established by the

Eastern, Central and Southern Africa PTA has revealed several issues which need to be considered, if these changes are to be adequately effected.

First, there is a need to study the various aspects of company law of PTA countries with a view of assessing how they can be harmonised or how common elements can be developed. As the company law of these countries reflects the law of their former colonisers who are now active EEC members, a comparative study of how EEC is harmonising the company law of member countries and how it establishes new regulations may be of great assistance.

Secondly, in order to form joint venture companies which involve only the participation of PTA nationals, deliberate efforts to develop complementary opportunities are necessary. This also needs research on the availability of complementary opportunities by nationals of different member countries. The ASEAN PTA which once faced more or less similar problems is in the process of devising some solutions. Thus, ASEAN may provide a good number of lessons to be learnt by the Eastern and Southern Africa PTA on this aspect.

Thirdly, the study of the availability of regional or local complementary opportunities will help to develop an understanding of the local or regional potential for joint venture formation. This will involve removing the current superficial determinant of the threshold for foreign companies' participation which is based on the percentage of share-ownership. This study has shown that in a situation where there is no local complementarity, limiting the TNC equity participation to a certain percentage does not ensure local control or even joint control.

All the suggested changes recognise that economic interdependence cuts across various business structures and nations. Further that, it can only be solved through co-operation, not confrontation. Tanzania, like other developing countries, needs a legal framework which reflects co-operative elements within and between companies, and between nations. Thus, further studies to this end are necessary.

APPENDICES

APPENDIX 1

THE JOINT VENTURE SHAREHOLDERS AGREEMENT BETWEEN TANZANIAN COMPANIES AND FOREIGN COMPANIES. (some important clauses)

THIS AGREEMENT is made the day of One thousand nine hundred and
BETWEEN:

PARTIES:

(1) [] a private company incorporated in [*name of the foreign country*] whose registered office is at [], (hereinafter referred to as 'Company A'); and,

(2) [], a Tanzania public corporation established by Act No. [] of 19[...], (hereinafter referred to as 'Company B'); and,

(3) [] a private company incorporated in [Tanzania] whose registered office is at [], (hereinafter referred to as 'Company C'); and,

(4) The Joint Venture Company Ltd. (hereinafter referred to as 'the Company').

WHEREAS:

(A) Companies A, B, and C have agreed to establish a joint venture company (the Company) in [Tanzania] to carry on the business of [*in accordance with the Memorandum of Association in Schedule A*].

(B) The company was incorporated in Tanzania on [], 19[] and at the date hereof has an authorised share capital of Tshs. [] divided into [] Ordinary Shares of Tshs.[] each of which [] have been issued at a subscription price of [] and are held by Co. A (hereinafter referred to as 'A' Shares), and [] have been issued at a subscription price of [] and are held by Cos. B and C (hereinafter referred to 'B' Shares).

(C) It is the intention of Shareholders that each of them shall share and participate equally in the management and control of the Company and the Shareholders have agreed that their respective rights as Shareholders in the company shall be regulated by the provisions of this Agreement and the Articles, with the former having precedent in case of conflict.

(D) The Company has agreed to comply with such matters herein contained as they relate to the Company.

(E) Pursuant to this Agreement the parties have agreed that an Extraordinary General Meeting of the Company will be held and that there shall be passed thereat as special resolutions of the Company to comply with the provisions of this Agreement.

NOW IT IS HEREBY AGREED as follows:

1. Definitions and Interpretation.

In this Agreement (which expression shall be deemed to include the annexes and schedules hereto) the following words and expression shall have the following meanings:

"A" Director' means a director holding office pursuant to a notice given by the holders of [a majority] of 'A' Shares in accordance with the Articles.

"B" Director' means a director holding office pursuant to a notice given by holders of [a majority] of 'B' Shares in accordance with the Articles.

'Articles' means the Articles of Association of the Company set out in Schedule A.

'A Deed of Adherence' means a deed in the form set out in Schedule B or a deed in such other form as Shareholders may agree.

"A" Shares' mean the Ordinary Shares to be designated 'A' Ordinary Shares in the capital of the Company as contemplated by Clause 4.

"B" Shares' mean the Ordinary Shares to be designated 'B' Ordinary Shares in the capital of the Company as contemplated by Clause 4.

"A" Shareholders' mean the persons from time to time registered as holder(s) of 'A' Shares.

"B" Shareholders' mean the persons from time to time registered as holders of 'B' Shares.

'The Companies Ordinance' means the Tanzanian Companies Ordinance (Cap. 212 of the Laws).

'Group' means in relation to a company, that company and any company which is from time to time a holding company or a subsidiary (or a company under control contract) of that company or of such holding company.

'The Group' means the Company and its subsidiaries (if any).

'Shareholder' means the 'A' Shareholder or the 'B' Shareholder from time to time, as the case may be, and expression *'Shareholders'* shall be construed accordingly.

'Share' means a share in the capital of the Company of whatever class.

'Joint Venture Project' means the project to be undertaken by the Company.

'Shillings' and *'Tshs'* mean the lawful currency of Tanzania.

'Person' includes any body of persons, corporate or unincorporate.

Other expressions defined for the purposes of the Companies Ordinance shall bear the same meanings herein.

1.2. Unless the context otherwise requires, any reference to a statutory provision shall include such provision as from time to time modified or re-enacted or consolidated so far as such modification or re-enactment or consolidation applies or is capable of applying to any transactions entered into hereunder.

1.3. The headings are for convenience only and shall not affect the interpretation hereof.

2. Condition Precedent and Consents.

This Agreement shall not come into force until:

2.1. Licences, clearances and other approvals as may be required by the law have been obtained from relevant authorities. [*duties and obligations may be imposed on the parties to execute this provision*].

2.2. Financial Loan [*if applicable*] has been secured [*by the parties or the Company*].

3. Establishment and Structure of the Company

3.1. Meetings of the Board of Directors.

On entering into force of this Agreement the Shareholders shall procure the holding of the Board meeting and the passing thereat of a resolution concerning an Extraordinary General Meeting of the Company immediately following the adjournment of the meeting of the Board for the purpose referred to in Clause 3.2.

3.2. Extraordinary General Meeting.

Upon the calling of the Extraordinary General Meeting the Shareholders shall give consents to short notice in respect of such Extraordinary General Meeting and shall attend and vote thereat in favour of resolutions to comply with the provisions of this Agreement.

3.3. Proceedings at the General Meetings.

The quorum necessary for the transaction of business by the General Meeting shall consist of persons holding or representing not less than [75%] of the capital of the Company, but so that such quorum shall throughout the meeting include one person representing the holders of the 'A' shares and one person representing the holders of the 'B' shares.

4. Subscription and Allotment of Shares.

Forthwith upon passing the resolutions of the Company pursuant to Clause 3.2:

4.1. The Shareholders shall each complete, sign and deliver to the Company applications for allotment to them of the number of 'A' and 'B' Shares set against their names below.

Company A shall apply for 45% of the shares, which shall constitute 'A' shares, and shall be allotted and deemed paid-up in consideration for Company A's undertaking to provide machinery and expertise to the Company in accordance with the Technical Services Agreement annexed hereto as annex II.

Company B shall apply for 49% of the shares, which shall constitute a part of 'B' shares, and shall be allotted and deemed paid-up in consideration for Company B's undertaking to transfer or make available to the Company its immovable and movable assets under the Assets and Operating Agreement annexed hereto as annex III.

Company C shall apply for 6% of the shares, which shall constitute a part of 'B' shares, and shall be allotted for subscription in cash of Tshs. [].

4.2. Each of the Shareholders agrees that any shares taken by subscribers to the Memorandum and Articles of Association of the Company may be freely transferred so as to give effect to the allotments intended under Clause 4.1 above.

5. Directors of the Company.

Each Shareholder shall have the power to appoint a person or persons to act as its representative in the Board of Directors of the Company as provided hereunder:

5.1. Company A shall appoint (or confirm the appointment of) the following persons as the first 'A' Directors.

[]
[]

5.2. Company B and Company C shall respectively appoint (or confirm the appointment of) the following persons as the first 'B' Directors.

Co. B []
Co. B []
Co. C []

5.3. Board Meetings.

Board Meetings shall be held no less than [four] times in every year and at not more than [three months] intervals and unless otherwise agreed by a majority for the time being of the 'A' Directors and 'B' Directors [seven] days' notice shall be given to each of the Directors of all meetings of the Board, at the addresses notified from time to time by each Director to the Secretary of the Company. Each such notice shall contain, *inter alia*, an agenda specifying in reasonable detail the matters to be discussed at the relevant meeting.

5.4. The Chairman of the Board shall be the Director appointed by Company B and the Managing Director shall be appointed by Company A pursuant to Clause 5.6 below.

5.5. The quorum necessary for the transaction of business by the Board shall be three Directors but so that such quorum shall throughout the meeting include the Managing Director. Questions arising at any meeting shall be decided by a majority of votes provided nevertheless that no such decision affecting the rights provided under this Agreement shall be valid unless such majority includes the affirmative vote of the Managing Director or his alternate. The Chairman shall have a second or casting vote.

5.6. The business of the Company shall be supervised by the Directors who shall appoint, and generally delegate authority to the Managing Director, being a person made available under the Management Services Agreement, annexed hereto as annex I, to establish and carry out a programme for day-to-day management and operation of the Company in relation to the implementation of the Joint Venture Project.

6. Transfer of Shares.

6.1. Otherwise than in accordance with the following provisions of this Clause no Shareholder shall:

- (i) pledge, mortgage or otherwise encumber its legal or beneficial interest in its Shares; or

(ii) sell, transfer or otherwise dispose of any of such Shares (or any legal or beneficial interest therein); or

(iii) enter into any agreement in respect of the votes attached to Shares; or

(iv) agree, whether or not subject to any condition precedent or subsequent, to do any of the foregoing.

6.2. (i) If any Shareholder ('the Proposing Transferor') proposes to transfer any of its shares shall give notice in writing ('the Transfer Notice') to the Company stating that it desires to transfer the shares and specifying the price per share which in its opinion constitutes the fair value of the shares. By the Transfer Notice the Proposing Transferor shall authorise the Company to sell all the shares specified in the Transfer Notice. The shares shall first be offered to other Shareholders ('the Purchasing Shareholders') at the price specified in the Transfer Notice or at the fair value as between a willing seller and a willing buyer certified by the auditor of the Company (acting as an expert and not as an arbitrator), whichever shall be the lower.

(ii) Within [seven] days after receipt of the Transfer Notice the Company shall by written notice ('the Offer Notice'), offer the specified shares to the existing Shareholders (other than the Proposing Transferor) in proportion to the number of the shares held by each such Shareholder. The Offer Notice shall state the price per share specified in the Transfer Notice and shall limit the time within which the offer may be accepted to not less than [twenty one] days and not more than [forty one] days after the date of the Offer Notice. If any Shareholders do not accept the offer in respect of their respective proportions in full, the shares not so accepted shall be offered to the Shareholders who ask for additional shares in proportion nearest to the number already held by them respectively.

(iii) If the Company shall not give a Sale Notice to the Proposing Transferor within [seven] days, the Proposing Transferor shall, during the period of [twenty eight days] next following the expiry of the time so specified, be at liberty, subject to the provision of this Clause to transfer all or any of the shares specified in the Transfer Notice.

6.3. The parties hereto shall procure that before any person (other than a Shareholder) is registered as a holder of any share shall enter into a Deed of Adherence. The Company shall not register any person as the holder of any share until such a deed has been executed. Upon being so registered that person shall be deemed to be a party to this Agreement.

6.4. Notwithstanding anything else contained in this Agreement or in the Articles, but subject to Clause 8, neither Shareholder shall transfer any of its shares for a period of [5] years from the date hereof without the prior written consent of other Shareholders.

6.5. Notwithstanding anything else contained in this Agreement or in the Articles (but subject to sub-clause 4) neither shareholder may transfer its shares to a person who is not a party to this Agreement (otherwise than in accordance with sub-clause 6) unless the proposed transfer is simultaneously acquiring the whole of such Shareholder's business and undertaking or is already established in a business similar to that of such Shareholder and can establish to the other Shareholders' reasonable satisfaction that it is in the position to carry out all of such Shareholder's obligations under the Joint Venture Agreement.

6.6. If any Shareholder shall transfer all its shares to another member of its group ('the Transferee') then:

(a) the Transferor shall procure that the Transferee shall observe the provisions of this Agreement; and

(b) if there is breach of this Agreement the Transferor will be liable as if it were a party to this Agreement as a principal.

6.7. The Company shall not register any transfer made in breach of this Agreement and the shares comprised in any transfer so made shall carry no rights whatsoever unless and until, in each case, the breach is rectified.

7. Deadlock.

7.1. Whatever matter is submitted to a General Meeting of the Company and that General Meeting is unable to arrive at a decision on the matter by reason of disagreement between the Shareholders then a deadlock shall be deemed to have occurred in relation to that matter.

7.2. If and whenever a deadlock is deemed to have occurred either Shareholder shall be entitled, within [thirty] days after the date on which the deadlock occurred, by notice in writing to others, to require the matter to which the deadlock relates to be referred to [*an expert, arbitration, conciliation, court, see pp. supra and p infra*] for final determination.

7.3. If in spite of the determination in sub-clause 2 the said Shareholder is still not satisfied, that Shareholder shall serve a written notice ('Deadlock Notice') offering to sell or (procure the sale of) its shares to other Shareholders (within the class or within the Company, as the case may be), failing which, to purchase the other Shareholders' shares in accordance with the following provisions of this Clause.

7.3. The Deadlock Notice shall specify the price at which the Seller(s) is or are prepared to sell their shares but shall not include other condition whatsoever.

7.4. The Deadlock Notice shall be deemed to constitute:

(a) an offer by the Seller(s), open for acceptance by one or more of the Buyers for [one month] from the date of service of the Deadlock Notice ('the Buyer Purchase Period') to sell all (but not some only) of the shares to one or more of the buyers on the transfer terms as provided for under Clause 6.

(b) an alternative offer by the Seller(s) to purchase all (but not some only) of the Buyers shares within [seven] days after the Buyers' Purchase Period has expired and no Buyer has indicated its willingness to buy the Seller's shares, on transfer terms as provided for under Clause 6.

8. Duration and Termination.

8.1. Except as otherwise provided herein, this Agreement shall continue in full force and effect without limit in point of time until the earlier of the following events:

(i) the holders [of the majority] of the 'A' Shares and [of the majority] of the 'B' Shares agree in writing to terminate this Agreement; or/and

(ii) an effective resolution is passed or a binding order is made for the winding up of the Company;

(iii) there is a material breach of this Agreement;

provided however, that this Agreement shall cease to have effect as regards any Shareholder who ceases to hold any Shares save for any provisions hereof which are expressed to continue in force thereafter.

8.2. Subject to the foregoing provisions of this Clause this Agreement shall be re-negotiated after very five years.

9. Ancillary Agreements.

9.1. Pursuant to relevant Clauses in this Agreement the Company shall enter into [Management and Technical Services Agreements] with Company A.

9.2. Pursuant to Clause 4.1 of this Agreement the company shall enter into the [Assets and Operating Agreement] with Company B.

9.3. The parties have agreed that the contents of the agreements in sub-clauses (1) and (2) shall form part of this Agreement and are annexed hereto as annexes [I, II, and III] respectively.

10. Governing Law and Arbitration.

This Agreement shall be governed by and construed in accordance with the relevant laws of Tanzania and if any dispute shall arise between any of the parties hereto as to the application, performance or interpretation of this Agreement which cannot be resolved amicably within [thirty days] of having arisen, then such dispute shall be referred to [arbitration]. For the purpose of such arbitration parties shall each appoint one arbitrator and such arbitrators shall appoint a third arbitrator who is not connected in any way with either of the parties to such dispute and who shall act as the chairman, provided that if the arbitrators cannot agree upon such appointment, such dispute shall be finally settled under the Rules of Conciliation and Arbitration of [the International Chamber of Commerce] by one arbitrator or more appointed in accordance with those Rules.

ANNEXES:

Annex I.

The Management Services Agreement (pursuant to Clauses 5.6, 9.1 and 9.3).

Annex II.

The Technical Services Agreement (pursuant to Clauses 4.1, 9.1 and 9.3).

Annex III.

Assets and Operating Agreement (pursuant to Clauses 4.1, 9.2 and 9.3).

SCHEDULES:

Schedule A.

Memorandum and Articles of Association of the Company.
(pursuant to Recital A)

Schedule B.

The Form for the Deed of Adherence (pursuant to Clause 6.3).

APPENDIX 2

THE QUESTIONNAIRE USED IN THE RESEARCH OF JOINT VENTURE COMPANIES IN TANZANIA.

I: Introduction.

Address.....

Status.....

Joint Venture Company Establishment.

1. Name of the Joint Venture Company.....

2. Date of establishment.....

3. Was the joint venture company established under one or more of the following Acts, (please tick)

(i) Companies Ordinance ()

(ii) Public Corporation Act (1969) ()

(iii) Presidential Order ()

(please specify the order).....

(iv) Independent Act of Parliament ()

(please specify the Act).....

(v) National Investment (Promotion and Protection) Act (1990) ()

(vi) Others (please specify) ()

4.(a) Who were the initial subscribers (please give their names, nationality and number of shares)

Name	Nationality	No. of Shares

(b) Has their number of shares changed since then? (Yes/No).

(ii) If yes, who are they? (names, nationality and shares)

Name	Nationality	No. of shares

5.(i) Were there some other documents relevant to the establishment of the JVC, apart from those legally required? (Yes/No).

(ii) If yes, please identify them from the ones that are listed below. (please tick and mention the parties involved)

- (a) Joint Venture Shareholders' Agreement
()
- (b)Joint Venture Credit Facility Agreement
()
- (c) Joint Venture Licensing Agreement
()
- (d) Joint Venture Management Agreement
()
- (e) Joint Venture Technical Service Agreement
()
- Others (please specify)
()

(iii) Generally, how can you describe the mode of negotiating, drafting and executing these agreements (please tick).

- (a) Fair
()
- (b) Unfair to the local partner(s)
()
- (c) Unfair to the foreign partner(s)
()
- (d) Not fair (generally)
()
- (e) Other views (please specify)----- ()

(iv) Would you give an explanation for your choice in (iii)

(v) From your general point of view what do you believe parties intended to get from the agreement?

- (a) Foreign parties

(b) Local parties

(B) Do you believe parties were able to gain what they wanted after the formation of the joint venture company?

(C) When you consider the current structure and operation of the joint venture company, do you still believe that parties have been able to retain what they gained?

(vi) Do you think these agreements were necessary for the establishment of the joint venture company?

(a) All were necessary ()

(b) Some were necessary (please specify)----- ()

(c) None were necessary ()

(vii) (a) Do you think these agreements affect the structure and decision making of the joint venture company? (Yes/No).

(b) How?

II. Structure of the Joint Venture Company.

1. What is the ratio of share-holding between foreign and local shareholders -----:-----

2. (i) According to its constitution the joint venture company is a private/public company (please tick and/or delete when relevant)

(ii) Because:

(a) The majority foreign/local shareholders are private/public companies ()

(b) The majority shareholders are private/public companies ()

(c) Others (please add other reasons)-----

4(a) When you consider the mode of share-ownership in the joint venture company do you think it is proper to call it (please tick and or delete when it is relevant)

(i) A joint venture company ()

(ii) A subsidiary of the foreign/local shareholder(s) ()

(iii) A subsidiary of the company with majority shares ()

(v) A joint venture partnership ()

(b) Why would you describe it that way?

5(i) Do you think the share-ownership criterion is adequate to indicate the nature of the joint venture company? (Yes/No)

(ii) Why? (please explain)

III. Share Structure of the Joint Venture Company.

1. Is there any difference between the rights attaching to shares held in the joint venture company, according to: (please tick)

(i) Nationality of the shareholder ()

(ii) Type of contribution ()

(iii) Others (please specify)----- ()

2 (i) Are shares categorised in groups (classes)? (Yes/No)

(ii) If yes, please indicate the name of each group, the type of shares and rights attached thereto (e.g., voting rights, return of capital, dividends and others)

Class	Type of shares	Rights

3. Does the classification of the shares affect the decision making of the joint venture company? (please explain)

IV. Management Structure.

1. According to the structure of the joint venture company the management is: (please tick/delete where relevant)

(i) Shared by the members ()

(ii) Provided by local/foreign shareholders ()

(iii) Provided by an independent management ()

(iv) Others (please specify)----- ()

(A) If the management is shared please indicate who holds the following posts (please specify other posts not mentioned).

Post	Local	Foreign
Managing Director		
Financial Director		
Personnel Director		
Chief engineer		

(B) Is the arrangement of the posts permanent? (Yes/No)

(b) If not indicate the duration it takes to change them

(c) Are there any consideration in changing the bearers of the posts (Yes/No)

(d) If yes, what are they?

(C) In case the management is provided by one parent company, how are other shareholders represented in the decision making?

2. (i) Do you think the current management is effective and fair as between the parties? (please give your opinion)

(ii) How would you describe problems, if any, by the current management?

(iii) Do you think any changes are needed? (please give examples)

V. Decision making process.

1. How would you assess the current procedure of decision making by the company: (please tick).

(a) Very Adequate ()

(b) Adequate ()

(c) Fairly adequate ()

(d) Inadequate ().

2. According to the joint venture agreement, the board of directors is constituted by (please tick or delete where applicable)

(i) Equal number of representatives from shareholders ()

(ii) Representatives from the local/foreign shareholders only ()

(iii) The majority representatives form local/foreign shareholders ()

(iv) Others (please specify)----- ()

(b) How many times does the board meet annually (please give the average figure).....

3. How would you assess the relationship between the board of directors and: (please give reasons for your view)

(a) Shareholders-----

(b) Management-----

(c) How would you assess the board in making its decisions, it is:

(i) Independent ()

(ii) Influenced by the foreign/local partner ()

(iii) Influenced by the management ()

(d) How would you account for the choice you made in (c) above-----

4. A (i) How many times does your joint venture hold a general meeting (i.e., ordinary and extraordinary general meeting, on average basis)-----

(ii) Do all members attend? (please indicate whether there are other alternatives of representation in cases where some members do not attend)-----

B. Are there some special requirements in passing: (please indicate these requirements against your answer)

Yes	No	Requirement	Reason
		a special resolution	
		an extraordinary resolution	
		an ordinary resolution	
		others	

C.(i) Are the members of the general meeting allowed to use informal procedure (e.g., a letter signed by all shareholders) in lieu of a resolution by the general meeting? (Yes/No).

(ii) If yes, how many times does this happen?-----

5. (i) Does the joint venture company require any special majority in passing some or all decisions? (Yes/No).

(ii) If yes, please indicate the subject matter of the decision and the special majority required.

(iii) Does the joint venture allow class meetings? (Yes/No)

(iv) If yes, how many times a year does a particular class hold its meeting?

(v) Do class resolutions represent the view of the class in the general meeting? (i.e., no member of the class can vote against the class resolution (please explain how this is dealt with by the company)).-----

VI. Regulation of the joint venture company.

(In 1 and 2 please indicate the frequency of regulation, starting with 1 as every time, 2 many times, 3 regularly, 4 rarely, and 5 not at all)

1 Do you think the internal regulation of the joint venture company depends mainly on:

Directives from the management of the joint venture company	No.
Directives from directors	
Directives from all members	
Directives from local shareholders	
Directives from foreign shareholders	
Directives from the government	
Others (please specify)	

2. In making the directives the following documents are important

The joint venture shareholders' agreement	
The memorandum and articles of association	
The Management agreement	
The consultancy agreement	
Government regulations	
Others (please specify)	

3. Do you think it is necessary as far as joint venture companies are concerned, for company law and other relevant statutes to provide for: (please tick)

Mandatory registration of the company	Yes	No
Minimum number of members		
Registration of allotment and transfer of shares		
Mandatory keeping of books of accounts and balance sheets		
Mandatory inspection and auditing		
Duties/obligations and rights of directors		
Protection of minority shareholders		
Compulsory declaration of dividends		
Process of winding up the joint venture		
Others (please specify)		

(b) Do you think the current Companies Ordinance and other relevant statutes are adequate in the aspects which you consider important for the law to provide (please explain)

(c) How do you think these laws should be improved?

VII. Government policy on joint ventures.

1. Do you think it is necessary for a company which wants to invest in Tanzania through a joint venture, to apply for a certificate of approval under the National Investment Act (1990) in addition to following other normal procedure of incorporating a company? (Please explain)

2.. (i) Do you think it is fair/proper for the government to give exclusive rights of investment to the public sector and local private investors in some areas of investment as provided under part B and C of the National Investment Act (1990)? (please explain)

(ii) Do you think a TNC should be excluded form investing in the areas under (i) if it decides to invest in a joint venture form with a local company?

3. In your opinion, do you think the National Investment Act (1990) is adequate as far as joint ventures are concerned? (please give reasons for your opinion)

VIII. General Opinion.

1. In your opinion do you think joint venture companies need a special legal framework which would regulate the process of their formation and operation?

2. What matters should be dealt with by such a legal framework?

Thank you for your co-operation.

APPENDIX 3

LIST OF TANZANIAN PUBLIC ENTERPRISES, ALREADY SELECTED FOR PRIVATISATION BY 1993.

Table 6.2. Initial assessment of divestiture methods.

Divestiture Method	Number of enterprises
Public share offering	12
Private sale including joint ventures	160
Public auction	27
Management buy-out	12
Management contracts or lease of assets	17
Liquidation	67
Retained in the public sector	16
Transfer to appropriate ministry	4
Displacement	29
TOTAL	344

Source: From the 1993 Master-plan by the Tanzanian Presidential Parastatal Sector Reform Commission, Dar es Salaam, 1993.

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