

INTERNATIONAL JOINT VENTURES

Second Edition

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JURIS

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Printed in the United States of America.
ISBN: 978-1-57823-315-1

Juris Publishing, Inc.
71 New Street
Huntington, NY 11743 USA
www.jurispub.com

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Introduction

Although joint ventures were not formally repealed as legal instruments in Romania, they were banned for almost forty-five years, until the fall of the Communist regime in 1989. The early 1990s marked the re-establishment of democracy, thus creating favorable conditions for reverting to joint ventures.

Private entrepreneurs rapidly embraced this new opportunity, primarily because of the liberal fiscal regime and the ease of setting up joint ventures. State-owned companies frequently used this scheme in restructuring and in the development of their partnerships with private investors.

A joint venture is generally defined as a form of partnership between two or more investors for jointly conducting a commercial activity or an entire business to obtain profit. To this purpose, each party makes a contribution (i.e., capital, property, know-how), bears its share of expenses, and is entitled to part of the profit resulting from the joint venture business operations.

According to the Commercial Code and the Civil Code, joint ventures are *de facto* partnerships rather than legal entities serving as investment vehicles. Thus, a joint venture established in Romania under the Commercial Code is not a new legal entity, and the joint venture business activities are practically assumed by one of the parties to the partnership.

However, investors may set up a new legal entity for joint venture by incorporating a new company in accordance with the Company Law.¹ A joint venture may thus be implemented in accordance with the provisions of the Commercial Code as a partnership, or under the regulations of the Company Law as a separate company.

Opting for any form requires thorough consideration, as the legal status of a partner and a shareholder are hardly similar. Each type of joint venture is subject to a different legal regime, especially as regards liabilities and fiscal treatment.

¹ Law Number 31/1990, as amended and supplemented.

Joint Ventures Regulated by the Commercial Code

In General

A joint venture regulated by the Commercial Code does not have legal personality, and the partners develop a business relationship between themselves only on a contractual basis.

There are no specific formalities for establishing a joint venture, but the existence and conditions of these formalities may only be evidenced by a written deed or contract.

Features and Operation

Parties to a joint venture may be merchants, non-merchants, or companies. However, non-merchants may be parties only to the extent of the commercial activities performed by them. There is no restriction on the number of parties, and there are no prohibitions with respect to the category of partners that may participate. Nevertheless, the nationality of a party triggers a differentiated fiscal treatment.

There also are no restrictions regarding the scope of the joint venture, which may cover one or more business operations or an entire business, except where non-merchants are involved. In such a case, only business operations considered *ut singuli* may be subject to the joint venture.

As a joint venture partnership does not have a legal personality separate from the partners, third parties may find it difficult to enforce their rights arising from the joint venture operations. To remedy this, the Commercial Code requires business operations to be carried out by only one of the partners (main partner) on behalf of the partnership.

Although acting for the benefit of the joint venture and on behalf of the other partners (secondary partners), the main partner is the only one who may enter into agreements with third parties. All rights and undertakings that arise under contracts with third parties are assumed by the main partner in its own name. Accordingly, all liabilities in connection with the joint venture operations toward third parties also are solely incurred by the main partner.

The Commercial Code does not clearly outline the obligations between partners. Although it expressly stipulates that the secondary partners should be informed regarding the status of the contributions brought by them, as well as the benefits and losses of the joint venture, these rights are not accompanied by appropriate guarantees. To this extent, the joint venture agreement should provide for protection instruments and appropriate mechanisms that will ensure that the secondary partners are accurately informed of and involved in the contemplated business operations.

Security also should be considered with regard to each partner's contribution and the proper sharing of profit. A security interest in the form of a receivables assignment agreement may be created, allowing the main partner to be replaced by the secondary partners in contractual relationships with third parties, enabling the secondary partners to gain control over commercial operations.

The payment of the relevant share of the revenues to each partner also may be secured by mortgages, pledges, or various financial instruments such as on-demand bank letters of guarantee.

Liabilities

As the joint venture does not have the capacity to sue and be sued, any contractual claim relating to the operation of the joint venture should be brought against the main partner, and insolvency procedures may only be commenced separately for each of the partners. The partners usually agree that should the main partner become liable to third parties, it will be indemnified by the secondary partners *pro rata* or in another percentage previously agreed upon.

Thus, the secondary partners do not gain any rights against and may not be held liable to third parties. Nevertheless, the partners may choose to always contract directly with third parties, in which case liability toward third parties is shared due to the direct contractual relationship.

The rights and undertakings of the main partner and the secondary partners should be clearly stipulated in the joint venture agreement. The liability between partners will generally be contractual, governed by principles based on the operating rules of the joint venture that are freely determined by the parties.

Third parties that are not in a contractual relationship with the main partner may claim for damages resulting from the joint venture operations under specific tort liability regulations.² Such claims will have to be filed only against the partner or partners directly responsible for the damage, and such partners may be held jointly liable. Although the partners may agree on sharing liability towards third parties, such agreement cannot be enforced against third parties.

Contributions

Contributions in the joint venture may be in the form of capital, assets, know-how, or labor. In the absence of provisions in the joint venture agreement to the contrary, the assets contributed to the partnership become the property of the main partner. Such ownership right is irrevocably and unconditionally

² Under Romanian law, tort liability may arise provided the plaintiff cumulatively proves the extent of the damage, that such damage was personally caused by the defendant, that the damage was the defendant's fault, and that the actions causing the damage represent a breach of law.

transferred to the main partner in exchange for the partners' right to participate in the gains and losses resulting from the business.

The joint venture agreement may stipulate that a secondary partner is entitled to regain such ownership right upon expiry or termination of the partnership. Should restitution be impossible, the contributing partner is entitled to claim indemnification only from the main partner. However, the parties may agree for the secondary partner to contribute only the usage right over certain assets, while maintaining ownership. In this case, the main partner is entitled to operate the assets as it sees fit, without having any disposal rights over such assets.

The secondary partners do not benefit from ownership over assets purchased by the main partner in the course of carrying out the joint venture's business activity, as they are not contracting parties to the ownership conveyance agreement.

The main partner acquires ownership and, upon termination of the joint venture, such acquisition causes the secondary partners' receivables right to increase, by applying their participation quota to the value of the said assets.

Termination

A contractual joint venture may be terminated by:

- Mutual agreement of the parties;
- Expiry of the term agreed by the partners, or the duration of the envisaged commercial activity if no such term is fixed;
- Fulfillment of the scope of the joint venture;
- Insolvency or winding-up of any of the partners;
- Termination for default through court decision due to non-fulfillment of major undertakings;
- Termination for convenience under cases specified in the joint venture agreement; and
- Termination for convenience under the general provisions of Romanian law, provided the joint venture's scope resides in the main partner's entire business and the partners omitted to fix a term for the operation of the joint venture.

Given that a joint venture does not create a new legal entity, its dissolution is not followed by liquidation.

Fiscal Regime

Revenues obtained from joint venture business operations are subject to taxation according to the provisions of the Fiscal Code. The Fiscal Code clearly specifies that a joint venture is not a separate legal entity for taxation purposes, thus its

revenues and expenses are distributed to the partners *pro rata*, and each partner is taxed separately.

However, the taxation procedure depends on the nationality of the partner. Foreign partners are required to appoint one of them as representative before the fiscal authorities. The appointed representative will have to perform all mandatory fiscal procedures, including the payment of income tax on behalf of the relevant partners.

If the joint venture is comprised of Romanian and foreign partners, then the mandatory fiscal procedures should be performed by a Romanian partner. Each Romanian partner is to perform the formalities for itself.

Joint Ventures Regulated by the Company Law

In General

Although not expressly stated under Romanian law, the purpose of a joint venture also may be achieved through the use of various forms of legal entities that have a legal personality.

The Company Law allows for several different types of companies, but practice has proved that limited-liability companies and joint-stock companies are the most relevant choices in the implementation of joint venture projects.

Features and Operation

Possession of Legal Personality

Compared to joint ventures regulated by the Commercial Code, the establishment and operation of companies is more complex and less flexible.

The distinctive legal personality of a company leads to significant changes from the structure, operation, and legal regime of a joint venture under the Commercial Code.

Establishment of Companies

Companies should meet certain mandatory requirements for incorporation. First, the setting up of a company should be authorized either by the manager of the trade registry office in the place where the company's registered office is located, or by a person commissioned for this purpose. This authorization process may be conducted by commercial registrars in the near future, hence, an agreement between the shareholders may not be sufficient. Furthermore, companies are required to have:

- A constitutive deed (articles of association and bylaws)³ which contains the name and logo of the company, and information regarding the scope of business, registered office, duration and termination of the company, share capital, shareholders, and any other relevant information regarding the operation of the company;
- A registered office;
- A minimum share capital of about EUR 60 for limited-liability companies and at least EUR 25,000 for joint-stock companies, which may be paid in capital and in-kind contributions;⁴
- A primary scope of business, with a secondary scope of business being optional;⁵
- A specific form of management, as well as one or several appointed directors; and
- A specific formula for distribution of profits or losses.

Operation

The corporate body of a company, responsible for making decisions and exercising general supervision of business activities, is the general assembly of shareholders. On the other hand, the day-to-day business of a company is carried out by its directors, which are entitled to act independently unless otherwise provided by the constitutive deed.

The company is generally represented by each of its directors, unless otherwise provided in the constitutive deed or by decision of the general assembly. Directors may not appoint a third party as representative of the company unless authorized to do so under the constitutive deed or with prior authorization by the general assembly.

Assignment

In general, the shares held in a joint-stock company may be assigned without any restrictions, unless otherwise provided by the constitutive deed.

3 These should be executed in notarized form where land is contributed to the share capital or if a joint-stock company is incorporated through a public offering.

4 Shareholders of a joint-stock company also have the option to contribute with receivables, but this is prohibited in the case of joint-stock companies incorporated through public offering. Contributions consisting of supply of work and services are expressly prohibited by the Company Law.

5 However, the description and content of any scope of business is regulated by law (which is similar to and based on the International Standard Industrial Classification, Revision 4, and NACE, Revision 2, of the European Union), the shareholders merely having the option of choosing from a predetermined list.

As for limited-liability companies, shares may be conveyed freely between shareholders, but the transfer in favor of third parties is conditioned upon the approval of the holders of three-quarters of the share capital.

Liabilities

The civil liability of the shareholders is limited to their share capital contribution, and only toward the company.

This is because a company engages in business operations and enters into agreements with third parties in its own name, and not as a representative of the shareholders. Hence, third parties may file claims only against the company, without the option to sue the shareholders directly.

Dissolution

Under the law, a company may be dissolved in the following situations:

- Expiry of the period for which the company was established;
- Impossibility of achieving the company's scope of business;
- Company voidance;
- Decision of the general meeting of shareholders;
- Severe conflict between shareholders that prevents the company's successful operation;
- Bankruptcy;
- Decrease of the share capital below the legal threshold;
- Decrease of the number of shareholders below the legal threshold; or
- Court decision, according to law.

As a result of dissolution, companies enter into the liquidation procedure, which involves the conversion of its assets into cash, and the cashing in of receivables that it holds against third parties. However, if the articles of association provide rules governing the company's liquidation process such that the shareholders excluded certain assets from liquidation, such assets will be distributed to the shareholders so long as all company debts are paid.

Payment of the company's debts is made from the proceeds of liquidating its assets. For the purpose of settling the company's debts, the liquidators may issue bills of exchange, enter into loan agreements, or pay debts out of their own resources. Liquidation will not release the shareholders or prevent the application of the company bankruptcy procedure.

Fiscal Regime

In accordance with the Fiscal Code, companies are subject to taxation on the profit obtained from the joint venture business operations. The shareholders cannot be held liable for any of the company's tax liabilities and do not have any obligation in relation to such tax liabilities, save for the approval of the company's annual balance sheet and the annual budget.

Each shareholder is liable for tax imposed on the dividends it receives. The conclusion of a shareholders' agreement, followed by the setting up of a company, does not create a different fiscal regime for the shareholders of the company.

Joint Ventures with State-Owned Companies and Local Authorities

Joint ventures have often been entered into by state-owned companies or local authorities, as they lack the know-how and financial resources necessary in sophisticated structure developments.⁶

State-owned companies are permitted to enter into either of the two forms of joint ventures. However, Law Number 15/1990 requires the joint venture agreement to include provisions regarding the partners, contemplated business operations, contributions, management and administration, distribution formula for profits, termination, and assets restitution.

Law Number 215/ 2001 gives local authorities the right to set up joint ventures with foreign and Romanian legal persons, but only for jointly financing and accomplishing activities, individual operations, services, and projects of local public interest.

A draft law on public-private partnerships is currently pending before the Parliament in view of broadening the opportunities for establishing joint ventures between private investors and public authorities.

⁶ For instance, several local communities appeal to foreign investors to be able to extend and restore utilities networks (i.e., water and sewerage systems). This particular type of joint venture is highly advantageous to both parties, as the community enjoys the use of such systems at higher standards and with broader coverage while the investors have a predictable, stable, and sustainable margin of profit. More recently, local communities in major cities that are faced with the growing need for homes have entered into joint ventures for the development of housing projects. In these cases, the city is usually the one providing the necessary land for construction, while a private investor erects housing facilities at its own expense. Upon completion of these projects, the profits from the resulting facilities are divided according to a ratio agreed upon in the joint venture agreement.

Conclusion

Considering the regime of joint ventures with and without legal personality, it is for the partners to appreciate the form that is most suitable for a specific project. Joint ventures regulated by the Commercial Code provide more flexibility, with the partners being allowed to decide every aspect of the contemplated project, save for the mandatory obligations of the main partner. Moreover, secondary partners may benefit from a high degree of discretion or even total obscurity, as the main partner may conceal from third parties the extent of its capacity or the real beneficiaries of the business operation.

One of the most important advantages of this type of joint ventures is that revenues obtained from and expenses incurred by the joint venture activity are distributed to the partners tax-free at the level of the joint venture. It is only upon calculation of the resulting profit that the relevant partner is liable for tax.

There also are some disadvantages to such joint ventures, which could make the setting up of a company the better choice. The main partner's absolute control over business operations gives rise to the need for creating appropriate measures to secure partners' rights and involvement in operations. Also, the assets contributed to the joint venture and acquired in the course of the business become properties of the main partner, unless stipulated otherwise.

The use of a company for the purpose of a joint venture has its own advantages. As the company has its own legal personality, its obligations are separate from those of its shareholders. Each partner becomes directly involved in the decision-making of the company and in the supervision of its statutory bodies.

Furthermore, all contributed assets become the property of the company and not of any of the shareholders. However, the joint venture partners would be disadvantaged because the revenues are first subject to profit tax applied to the company, and then further taxed as dividend income to the shareholders.