Technology Transfer through Joint Venture
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Lecture – 16
Preparation for SPV

I welcome you, in, lecture regarding the transfer of technology through Strategic Alliance and Joint Venture. And this is lecture 16, mainly on special purpose vehicle. And in this particular lecture I will concentrate more on preparation of special purpose vehicle. Now special purpose vehicle popularly known as SPV, rather most of the people use the word SPV instead of a special purpose vehicle.

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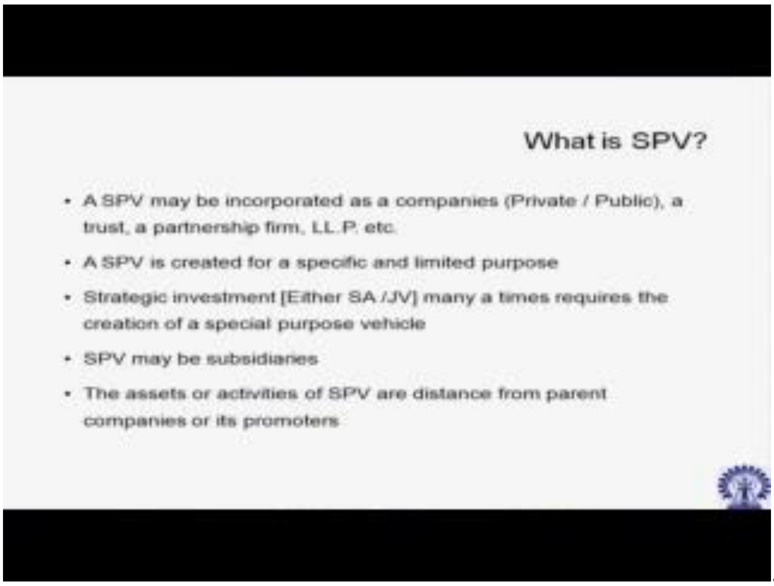

Now, before I go ahead, let me tell you, what is this particular SPV all about. And then I will take you through, how, what are the things you should do, before you will go ahead information or incorporating the SPV. Now, to put it in a very simplest form, SPV is generally a business form. So, it might be a companies, it might be a trust, and it might be even a LLP, or the partnership. But you will find the SPV, whatever is incorporated or been promoted, are generally the companies.

Trust, LLP s or the partnership are not very chosen form of a business, for the SPV. But in it is it is also differ with the different country, in some country we will find people prefer more partnership, because it is a flexible kind of relations in between the parties who are promoting this particular organization. Or which I have discussed with you before, that if it is a Strategic Alliance, where it is less formal form of a business, which you wanted to promote, out of the Strategic Alliance, then you might choose to go for a partnership. But if you are interested to go for a formal relationship, then it is always advisable that you should go for formation of the company, or incorporation of the company

Now, the LLP has come into the existence last few years. So, many people, if it is service related, and where you, you do not require to have an initial capital investment, or large capital investment, you might even choose for LLP. Because LLP is a simpler form even than that of a Private Limited Company, or a Public Limited Company. Now, if you feel that you know, the area where you are incorporating the company, which is required a formal business form, which is capital intensive or the regulated in that particular sector, suggest that the Joint Venture has to be form as a company, or special purpose vehicle as a company, then in that case it is suggested that you look into that particular sector, or regulation, and form accordingly.

So, if you need to have a more capital intensity, then you should go for a Public Limited Company, otherwise, you can go for a Private Limited Company too. Now many of the time you will find this SPV, is created for a specific and limited purpose. That means, you define, that what purpose you are incorporating this particular SPV, which is according to the Joint Venture agreement, or Strategic Alliance agreement, and whatever you have decided, in that particular Strategic Alliance agreement or Joint Venture agreement, you put all those particular things in the objective clause. So, that means, the purpose of this particular SPV is defined.

Now, you know, it is also for the limited period. That means, you wanted to carry out this particular Joint Venture may be for a 5 years, or you might want to renew that particular Joint Venture for another 5 years, and maybe after 10 or 15 years of time, you want to put down this particular Joint Venture, or Strategic Alliance. In that particular circumstance, you wind up once this particular time period is over. So, while you are forming the SPV, you should keep in the time period in mind, because time period is in important, relating to the determination of the rights and the liability of the partner who are coming into this particular SPV. So, you should not create such clause, within the

SPV agreement, or within the SPV document, which will create a problem, for a SPV to exit from the market, when this particular time comes to an end. So, this thing you should keep in the mind.

Now, second thing is, Strategic Alliance investment as I have talked with you, may require, you know, the special purpose vehicle. So, which I have discussed with you in the previous model that, Strategic Alliance might not require formation of any business organization, or even in case of the Joint Venture, if it is a informal Joint Venture, then you are not require to have a formation of any business organization, or business form. So, you know it is, SPV is only requires in those particular circumstances, where you need to go for a separate business form.

Now why you go for a separate business form, is depending on the type of business which you want to incorporate, or which you wanted to promote. It might be the intensity of fund, which you required to have for this particular business, or it might be the regulated reason, we suggest, that you know, there should be some kind of a business form, while you are making the investment. Or, it might so happen, that you want to have independent management, and the sponsorer or the promoter of these particular SPV, or the partner of the Joint Venture, want to keep them some in distance, in this new new venture, then that is also they can go for formation of SPV.

Now, many of the time will find the SPV is treated as a subsidiary of a holding company. That means, one of the company, or one of the partner, who use a partner in the Joint Venture, he is become a holding company of this particular SPV. So, it is depending on what kind of a business he wanted to promote, and what is the matter he wanted to address in the business and accordingly you should, you know, form or, you know, incorporate this particular SPV.

Now, assets and, or the activities of the SPV are distant from the parent companies, and its promoter and that is always you should keep in mind. Because the moment you were going to mix it this particular two thing, you, your SPV might be in trouble, and I have discussed this particular point in detail, when I was talking with you, relating to the formation of the Joint Venture agreement, or Strategic Alliance agreement. Because, there should be some kind of a arm’s length distance, even though, you want to have influence over the policy decision, but you should know that, you should, you should avoid to interfere in nitty gritty of FDD’s operation.

Otherwise, there is every possibility that, SPV which is being promoted, might fail, but please do remember, which I am going to discuss little later, that,, most of the time the parent companies send their representatives in the management as well as in the board, which is newly formed. That means, the SPV which is newly formed. So, in one or other way around, they try to keep management close to their own company, but, you know, it is advisable that, you know you should keep a distance, from the parent company, otherwise the growth of the SPV might hamper.

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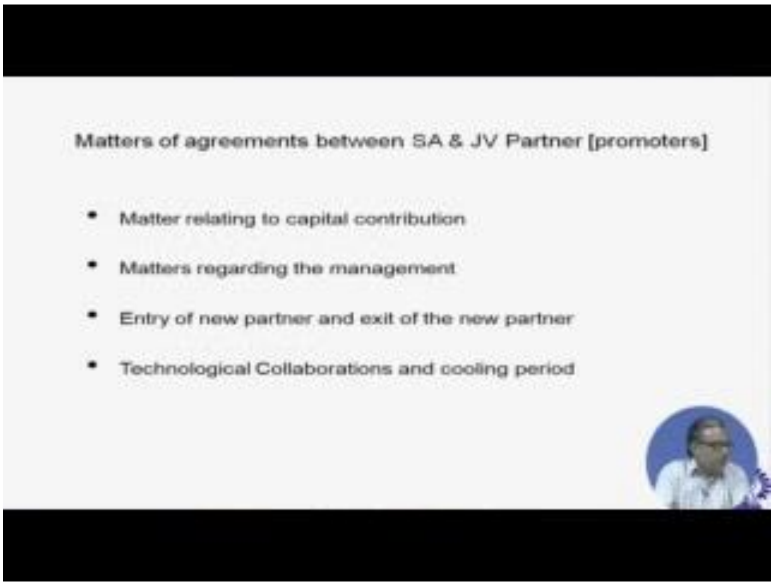

Now, let me take you to the next issues, which you should keep in the mind, while you are talking about the agreement of SA and JV partners, or the promoters, which is, which is commonly known as a promoters agreement, or which I have discussed with you in detail, relating to Strategic Alliance and the Joint Venture agreement, when I was discussed with you this particular issues. But you know we this is also commonly known as a promoter's agreement, sometimes people call it is a share holder agreement, whatever the name you call it, it is not an issue.

So, in this particular agreement, please be sure about the matter relating to the capital contributions, which is quite important issue, and I have talked to talk with you in detail while I was talking with the Joint Venture, and this particular capital contribution is important, when you are forming the memorandum of association of the company, Because at that particular point of time, you have to mention, what is the authorized capital, and who is going to subscribe how much capital during the formation of the company. Now, then you need to talk about the matter of the management.

That means you know what should be the structure of the board, how many people will be executive director, how many people will be non executive director, what should be their term, will they come from the parent company, or the sponsor company or Joint Venture partners or Strategic Alliance partner. So, you need to be detailing this particular issue, and then if you have specific terms of retirement circle, how, how this particular retirement is going to go, you need to write. Please remember, you cannot subordinate the provision of the statute, because, the companies says that, after particular period of time, the some director will be retire.

Now, please remember when am going to talk about the SPV, I more going to focus on the company's only. I am not going to talk about the trust, partnership, or LLP, because these are not very common form people choose in India, relating to the formation of the SPV. So, my entire talk and the discussion will be relating to the company only, and kindly do not get confused on that particular issue.

Relating to the trust, is generally used in cases, you have to hold something for the benefit of the Joint Venture members, or, somebody who is going to join in those particular Joint Venture in the future. So, that is our different ball game altogether, than that of a formation of the company. So, I am not going to deal with this particular thing here. But you know, it is important if you are transferring a particular technology, through this particular Joint Venture, where in you need to hold this particular technology through the escrow account, then that trust is good.

So, though trust is not very common thing, because you know, in case of the Joint Venture, generally people want to produce, something, out of the technology which has been transferred to this particular Joint Venture entity, instead of holding that particular technology. But if you think that well, you are transferring this particular technology because we wanted to do a further research on that particular technology; to bring the superior technology out of that, then in that case it is good to form a trust. So, am not going to discuss this particular trust issues more now. If it is possible in future, I am going to deal with this particular issue.

The next issue is, important issue is that you should talk about the entry and exit of the new partner. And I did discuss this particular issue in detail, when I talked with you in Joint Venture agreement, as well as Strategic Alliance. Because, if you do not have that particular flexibility, there is a possibility that your Joint Venture might fail in the future. Because when you have created the SPV, you are not sure, that what should be the situation in down the line, 2 years, 3 years, or 5 years, hence. So, there should be adequate provision should be made, where in you know, you should allow some your existing partner, to you know exit, or dilute the stake as well as the new partner to come in.

Let we give some examples which might give you some understanding about this. Like, you know, it might so happen, the government decide that the, your foreign partner stake need to be diluted, because there is a change in the regulation. So, in that circumstances, if your foreign partner have kind of 49 percent in the JV, the foreign partner need to reduce the particular stake, and if it is said, that you have to reduce up to 10 percent, then you have to reduce that. In that circumstance, you might want that new partner comes in, in the place where the foreign partner is reducing the stake, instead of your buying that particular reduced stake. So, whatever the circumstances will be in future, accordingly you should have that particular provision, so that the exit and entry is become easier.

Now, technological collaboration and cooling period is one of the very important things which I have discussed before also. But, let me caution you that when you were going to drop this particular cooling period, please do, please do remember that you have see the life of the technology. Most of the cases, life technologies are generally vary according to the industry. Like in some industry, you will find, the shelf life of the technology is 3 months, in some industry you will find the shelf life for the technology is something around 10 years, or 15 years. So, whatever the life of technology, or whatever the business you are in, accordingly you decide the cooling period.

Cooling period means, during this particular period, whenever you are going to exit that particular Joint Venture, other person is not going to gain a commercial advantage, commercial advantage, by transferring that particular technology to some other person.

But you know during that particular period of time, your partner might user technology and keep on producing whatever they are producing, as a part of the Joint Venture agreement. So, you need to decide these particular cooling periods, and as I told you that, it is depending on which sector you are carrying on the business

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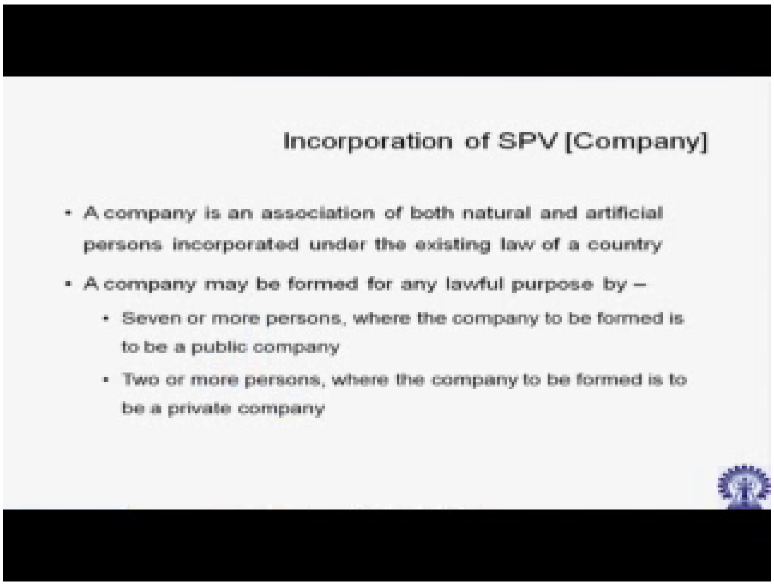

Now, let me take you to the next issues of incorporation of the SPV, and in my next subsequent lecture I am going to detail out this particular incorporation of this SPV. So, in case of SPV as I told to you, that I am, I am going to talk more on the companies only, am not going to talk about the other forms, because they are not usually used, but in certain circumstances they do use. Now, in case of the company, if you are forming the company which is a Public Limited Company, then you need to have a 7 or more member.

And if you are forming a Private Limited Company, then in that case you might have 2 or more person, as a promoter of that particular company. Let me tell you, you might be wondering, that if you have a 2 Joint Venture partner, from where you are going to get the 7 person to, you know, promote a Public Limited Company. Answer is pretty simple. The law says that in the post incorporation, there should be at least 7 members. So, some of the member should be your employee, and they are going to hold the shares in trust, for you. So, that particular part can be taken care of by this particular process. And in case of Private Limited Company, there is no such problem, because 2 percent can, you know, incorporate this particular company or promote the company.

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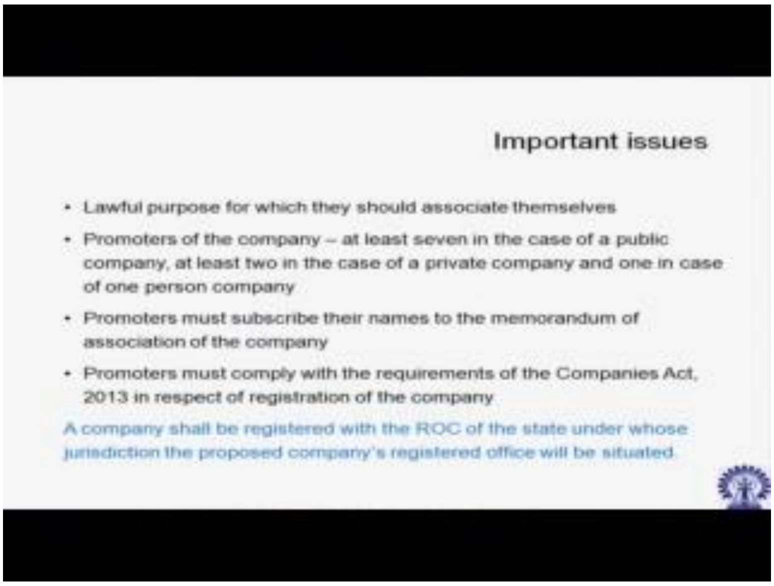

Now, other important issue you should incorporate the SPV for the lawful purposes. Now this lawful purpose is wide connotation or wide meaning. Now, lawful purpose means, any policy of the government, or any law or any regulation, or any guideline, or any good governance norm which is issued by the government, need to be complied with, while you are promoting the company. So, you are interested to promote a company which is going to do a research on the live stock. Like cattle or animals and all these things. Now the law of the land says that well you cannot promote this kind of a company, because it is a cruelty of the animal. So, you cannot incorporate SPV on that particular area. Or somewhere, the government says that some of the businesses are unethical in India, because the society do not permit. In those circumstances you cannot promote a company, on this particular thing.

So, you should check with your advisor, or maybe the professionals, that what, what comes within this concept of lawful purpose, because the lawful purpose varies according to the time, according to the society, and maybe you know, according to the political reign. Because sometimes, you will find some people take some decisions, which is where in the business allow, in some cases it not allowed. Sometimes, even it is depending on the financial and economic condition of that country. Like you know, some sector you will find the FDI is allowed, and there is a, 100 percent of FDI is allowed, but in that particular sector, the 100 percent FDI was not allowed 2 years back. It was only 50 percent, or it was only the 30 percent or 20 percent or 15 percent was allowed. So, that is what you need to keep on checking this particular thing, that what is a lawful purpose.

Now, then the next is, promoter of the company. At least in case of the Public Company 7, and in case of a Private Company, there should be 2 which I have talked with you. And when we are talking about the promoters is basically, indicating about those person who are going to subscribe the memorandum of association and article of the association. That means, 7 person has to sign into that particular memorandum and articles of association. Now who is a promoter? I believe I talked with you in the last lectures, but nevertheless, let me repeat it for your benefit. Promoters are those particular person who do everything, for bringing companies into life. That means, bring to incorporate the company.

Now in case of the Joint Venture a Strategic Alliance promoters are those partners. That means Strategic Alliance partner as well as Joint Venture partner. Please do remember, most of the cases, this Strategic Alliance partner and the Joint Venture partners, are the company. So, they promote another company as a Joint Venture company. And promoter, if you look into the definition of companies act, as well as the sacral laws, that mean, Sebi regulations, today you will find they give an elaborated definition of the promoter. Even, if you look into the RBI definitions, relating to the foreign invest, foreign investment, or you know, other other, you know sacral law, you will find they keep on defining who is a promoter.

To put it in a very precise manner, promoter is a person, who will have a control over the company, management in a posting corporation. So, that is a test. This control might come through the holding of the shares, or it might, the control might come some other process. But please do remember, any negative control will not be treated as control, for the purpose of the promoter. Negative control means they like you know, which generally greater (Refer Time: 21:46) does, they said that well if you wanted to go for structural change, or go for further investment, you need to come back to us, and then, you need to appraise us relating to this particular issue. These are known as a negative control. So, this kind of control is different than whatever the control, what control I have used for the purpose of the promoter.

Now, promoter, as I told you, they have to subscribe the name, in the memorandum of association, and promoter must comply with the requirement of the companies act, in respect of registration of the company. And once you do all this particular thing, you need to go to register of the company, under which state or jurisdiction you wanted to incorporate your company, and then you have to submit all the document. Now in my next lecture, am going to deal with what are the document, and the thing which you need to comply, while you are going for registration of a company.

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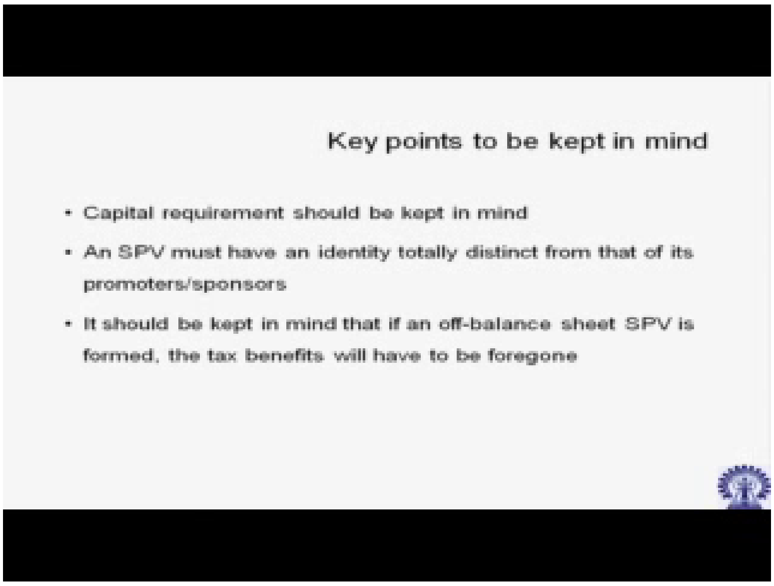

Now, keep on, you should keep in mind. So, these are in brief, the points which you should you know, keep while you are going for a permission of SPV. The capital requirement should be kept in the mind, and I have talked with you, that you know, you need to put the authorized capital, you need to talk about the issued capital, and I have detailed out that what kind of instrument you can make an investment while you are promoting the company.

And while you are subscribing the memorandum, then you know, how much you know, capital investment you have made you need to write. And later on, in which phases how much capital you are going to invest, or if some, some partner want to dilute their stake into that particular company, in which phase manner, or you know, in what manner they should dilute the stake. Everything should be you know, determined, before you go for SPV. SPV must have an identity, total distinct from its promoters and sponsors and I talk with you, a lot, on this particular issue.

Please, please, please make it arm’s length distance. Do not try to interfere, in day today activity of the SPV. Then in that case is every possibility that it might go down. Or if you know, if your partner is a foreign partner and they start remote controlling from the distance it is very difficult. Sometimes even there might be a cultural conflict, which might; you know bring down the business. So, it is always advisable that you should create some kind of a distinct entity

You should keep in mind, of off-balance sheet SPV if it is formed. Off-balance sheet SPV’s are generally those SPV’s, which are started with a very tiny capital, which do not have much independence than its sponsorer. That means the people who are promoting these SPV’s. If you want to do that or, or they can be simply treated as a subsidiary of the promoters. So, if you want to do that, then in that case you have to decide that, what should be the whole in stake, in that particular company or type of investment which you are looking from your partner, and what kind of a control which you wanted to give to your partner. So, off-balance sheet, you know SPV, are generally promoted by many of the government form, or where you wanted to have, kind of a, business which is not really cutting edge, or maybe, you wanted to use that particular SPV for developing particular R&D. So, these are, these are the, in those particular case of balance sheet SPV are good.

Or, if you wanted to get a tax benefit, because, through this particular process, or maybe if you wanted to have kind of a you know matter addressed, for the work men, benefitting the workmen or something like that. In those circumstances it is good to have off balance sheet SPV.

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Then, at the time of drafting the memorandum, of memorandum and article of the association, you should keep in the mind, the capability of acquiring, holding, and dispose of the assets, by this particular SPV. So, if they tomorrow wanted to do a spin off, then you should, there should be sufficient provision for that. Or even they wanted to go for acquisition, there should be some provisions relating to that. Or if they want to go for merger, then you should allow, that constitution should allow. There is, you know nowadays, there is a lot of triangle merger is happening, either it is reverse triangle or triangle merger. So, you should have that particular provision intact. Triangle merger are those merger, while in the subsidiary of a particular company is merged with another company. So, for the business purpose, you, you do this kind of activity.

Now, you should make sure, that SPV stands on his own feet. It is ownership, funding, management, and it achieves arm's length relationship, you know, which am repeating again and again, which is one of the mantra for success of a Joint Venture as well as SPV. Because it has been seen most of the cases, the SPV failed because of this. So, I will, I will advise to you, that when you are framing the terms and conditions, or framing the, you know, conditionality or, or the matter in the constitution of the company, you should keep this thing in mind.

Well next is, is well said, that you know, creating the SPV is easy, but maintaining the SPV is difficult. Why? Because there might be operational issues, there might be cultural issues; there might be wrecks which you have not adequately thought of, while you have entering into the, Joint Venture agreement or the SPV. Or there is a change in a business condition or business environment where you want to operate. So, I will advise to you, that you should have a flexibility built-in, within the constitution of the SPV. So, as the circumstances change, or the business environment changes, you should able to adjust that. And if there is a conflict, I have talked with you, a lot when I was discussing about JV agreement, you should have adequate internal mechanism to address this conflict resolution.

Now, you should look into the secretarial compliances then, the board meeting, general meeting, as prescribed the law then statutory filing, statutory registration, and filing of the forms and returns. That means, you know, whatever the disclosure is prescribed, by the different law under which you are operating, you need to comply with that. And as I have discussed with you, if you are in Public Limited Company or if you have incorporated a public listed company, then it compliance is very high. Please do remember, not only you have to file, normal returns, but you have to be careful about the corporate governance norm.

And if your return goes, goes particular level, or you know, touches a particular level, then you might need to have a CSR policy in-built within, within your system. So, this is the complex process, and you should plan it from the day one, or there should be a compliance, good compliance you know, mechanism should be build in, and if you do that, it manage, is manage your most of the operation wrecks.

The Board of Directors, in such subsidiaries is employee in most of the cases of the holding company. So, you the meeting are reduced in the formality, but you should not do that. You should do the meeting, as it is, meeting of this particular organization.

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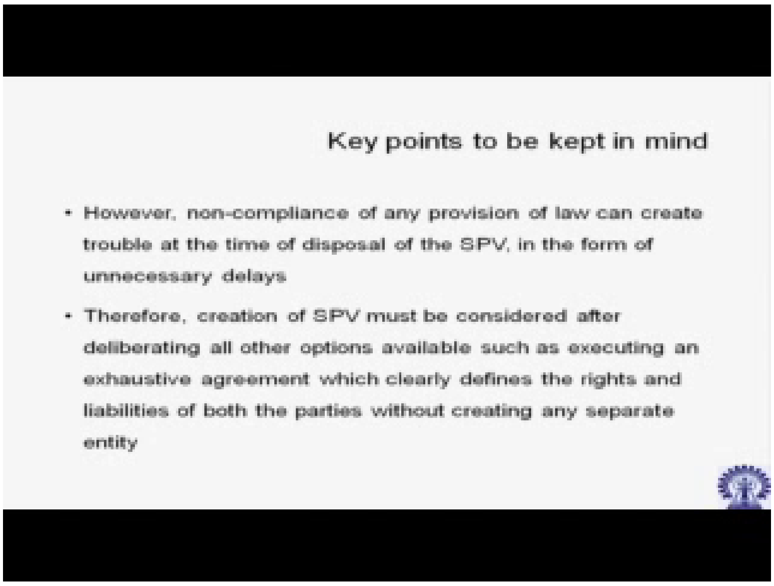

Because as, as I have told you that, you should promote this organization as independent to your sponsor, or the promoter. Now non-compliance of the provision might create trouble, and this might be creating unnecessary delay, the moment you wanted to you know, separate. That means you want to exit from that particular SPV, because as I told you in the beginning SPVs are for specific time, and specific purposes. So, once that particular purpose is over, you, you might want to exit. So, if you are not complying the law, or the process, or regulation of that particular sector, it might create a problem for you.

So, therefore, creating a SPV must be considered after deliberating all other point available, and you know, when you have really great deal of clarity, on the different aspect which I have discussed in the Joint Venture agreement, Strategic Alliance agreement, and relating to the promoters agreement, or in the formation of the SPV. So, SPV should be a conscious decision, and while you are promoting the SPV, you should be very clear about all the aspect which you might imagine, or which you might foresee, that you are going to face in the future.

Thank you.