

Questions and Answers Regarding Joint Ventures

QUESTION: Mr. McElroy, is there any target on when this joint venture will actually become profitable?

MR. McELROY: That is a difficult question. I am sorry I can't give you an easy answer. There are several elements to its profitability.

The joint venture itself, on its own accounting, is supposed to be profitable next year. But for Control Data there is an entirely different accounting because for instance, Control Data is supplying piece parts on a deferred payment basis, so you have to include the fact that there is an interest cost there. In addition, those piece parts are being furnished on a more or less fixed-price basis to the joint venture, but are not being acquired on a fixed-price basis, meaning that in some cases Control Data is paying more for the piece parts it is selling to the joint ventures that it is receiving. So you have to do two financial analyses. The joint venture will be profitable next year. When Control Data will obtain a profit from the overall transaction depends primarily on how many of the units that are manufactured and bought by Control Data can be sold, and at what price.

QUESTION: Who handles the sales outside of Romania?

MR. McELROY: The sale is completely free. All products must be sold to one of the two parents, and each parent is fully free to sell them to anyone they want to with some minor reservations about previous customers of each party.

QUESTION: You said there is some pessimism indicated with regard to the joint venture. Would there be any more optimism with regard to the sale of a turnkey operation?

MR. McELROY: I said that others have expressed pessimism. For me the question is still open. A turnkey operation, because it is more simple, has perhaps a greater possibility of success. But you must not forget that the same critical issues exist. In many ways you are only talking about different ways of doing the same thing. For instance, if you are talking about a turnkey plant where you are going to be required to acquire a number of the elements of that plant in Romania, you will have the same problems that a joint venture does, and that is: Can your Romanian suppliers fulfill your needs?

QUESTION: Two of the most obvious incentives for Western countries to enter into any sort of co-production scheme, joint venture, or whatever, in Eastern Europe are access to low-cost, stable labor supply, and access to markets through bilateral clearing or financial arrangements otherwise acceptable. The inclusion of export wages and all sales in dollars in this agreement here would seem to eliminate the two most obvious reasons to get involved. Mr. McElroy, what was your reaction to those terms?

MR. McELROY: You are right that one of the great incentives to any joint venture or to any cooperation agreement in these countries is their labor rates. The labor rates in the Control Data joint venture are extremely reasonable.

Incidentally, wages are fixed in the joint venture agreement in dollars, but that has nothing to do with what the employees are paid. The employees are paid in lei, and the amount of lei they get is set by national wage agreements which have absolutely nothing to do with the amount of dollars that are paid. However, when there is a national wage increase, the Romanians do put on a good deal of pressure to get a concomitant increase in the dollar rates.

As to the second part of your question, Control Data is working with the Romanians in an effort to find a way to utilize their bilateral and COMECON trade agreements in order to market the joint venture's products. This may involve setting up a separate joint venture trading company to market other products received in exchange.

QUESTION: I have a question for both Mr. Conner and Mr. McElroy. This is the question of termination of the joint venture. In other words, how do you get out of it?

MR. CONNER: In Yugoslavia the statute says the agreement must be a long-term agreement and should not be terminated prior to the achievement of its objectives, whatever that means; however, the statute goes on to say that you can terminate if the joint venture earns no profit for two years in a row or if the results are—I think their words are—“below expectations.” God knows what that means. If either party breaches its obligations, the other party may terminate the agreement and I suppose people acting in bad faith could engineer circumstances so you could terminate it by consent in that manner. In any event, you usually provide in the agreement how you are going to terminate the joint venture.

Aside from these statutory bases for termination, you can specify others in the joint venture agreement. For instance, you can agree that if the tax laws are changed in a materially adverse way, or if there has been a *force majeure*, you may terminate the joint venture.

MR. McELROY: That answer is entirely appropriate in the case of Romania as well. In Romania there is the additional problem, however, that you have an interest in a legal entity which is the owner of physical assets, but that entity is located in a non-market economy. Thus you can't simply provide in your joint venture agreement, as you might in the West, that the company will be dissolved in accordance with usual practice and law. So our agreement for the Rom Control Data joint venture has extensive provisions concerning the liquidation of the company in the event of termination. In essence, these require both parties to buy back their original contributions at book value.

QUESTION: When you transfer currency for the salaries of the employees through the national bank, first, at what exchange rate are they transferred into

lei; and second, what happens to the difference between the dollar value and the lei value? Is that absorbed by the bank?

MR. McELROY: That is the subject of about six of my 29 visas. The answer to your question is that the Romanians were adamant that exchange rates would not be discussed. Wages, as with all other supplies to the joint venture, are quoted in dollars. Only the most minor of expenses can be paid in lei. So the only exchange rate that is relevant is the exchange rate at which you can convert dollars into lei to pay those minor expenses. This is the so-called non-commercial rate, meaning the tourist rate. As far as salaries are concerned, we know approximately what the employees get paid. We know that even at the non-commercial rate there is a fairly large discrepancy. When we negotiated that subject, the Romanians said simply, "That is none of your business. We have social costs that you don't know about." In fact, while the lack of a contractual exchange rate was originally one of my concerns, it has not proved to be a problem in practice.

QUESTION: In Romania, is it an absolute requirement to use the joint venture structure, or can industrial cooperation and that sort of thing be used?

MR. McELROY: As far as I am aware, there is no reason why you cannot structure some sort of a cooperation agreement which would result in a split of "profits" if that is the way you want to go. The Romanians themselves, however, because of the existence of the law, and because it is a very new thing in Romania, are pushing it.

MR. STARR: I would like to say something positive which follows on that last question.

Renault has an industrial cooperation agreement with Romania that was negotiated in 1966, and it is really a complex licensing program that involves the production of one of the Renault line of automobiles in Romania. That program has been so successful from Renault's point of view, that Renault several years after beginning the program agreed to be solely dependent upon Romanian sources for the front and rear axle and a gear box of one of their own utility vehicles that they sell in France and Western markets, and they stopped producing those items for that utility vehicle. The program is structured as a cooperation agreement, and it has been working very well and will probably be renewed in some way. But Renault is very skeptical about the possibilities of doing a joint venture in Romania for some of the reasons we have heard today. They are quite happy working in the freer environment of a cooperation program.

QUESTION: Mr. McElroy, what is the mechanism for pricing the product that Control Data buys back?

MR. McELROY: In the joint venture agreement, all prices are fixed for a period of five years, and that is why the appendices have had to be "refurbished" so often. The prices obviously have changed enormously since the agreement was first negotiated, and so have the market and the products. That gives

me an opportunity to respond to something that Bob Starr said earlier. He is right in saying that this agreement had to be passed upon by the Council of Ministers in order to become effective, and that it was published in the official Gazette as a law. However, in order to maintain some essential flexibility we put in the agreement a clause that states "The shareholders of the joint venture may alter the appendices to this agreement as required by its business needs." This statement having in effect been enacted into law by the approval of the agreement, subsequent to the basic law that says you can't amend, means we can amend, and that is how we refurbish appendices.

QUESTION: Mr. McElroy, to what extent was the value of the Romanian's contribution negotiable?

MR. MCELROY: We agreed in advance on the value of their contributions as well as Control Data's. This is a practice I highly recommend to you. Originally the Romanians wanted to have a kind of commission which would value the various contributions (use of the land, buildings, equipment, training, and so forth) on the basis of some nebulous world market price principle. Instead, all of the contributions of both parties were at fixed prices agreed upon before hand.

QUESTION: How did you handle the preparation of financial statements for the joint venture? What is the applicability of United States general accounting principles?

MR. MCELROY: One of the best things that we did was to include in the negotiating team from the beginning a very top level accounting and financial man who has been associated with it ever since, and still is on the Management Committee. He spent a lot of time with the Romanian accountants learning their system. It is not terribly different from what we do, but it is presented differently and there are some different principles. Basically the joint venture prepares financial information in their format and Control Data has to take it and convert it in accordance with United States accounting principles.

QUESTION: Do they have independent accountants there?

MR. MCELROY: Not really. They have what they call the Treasurer's Commission. I think this is a bad translation. That is a group which, like the *commissaire aux comptes* in a French corporation, audits the financial statements, at least for the annual general meeting. (A lot of these corporate aspects, incidentally, of the joint venture are based on French principles, which were adopted in large part by the Romanians.)

QUESTION: Why do American businessmen prefer ownership rights in such cases?

MR. CONNER: I think it is really a misunderstanding on the average American businessman's and lawyer's part, the belief that there is a big distinction between a property right and a contractual right. As far as I am concerned you can have all rights of ownership through a contractual arrangement.

QUESTION: I hesitate to ask this question, but is there any such thing as “facilitating cooperation” and “expediting things”?

MR. McELROY: Absolutely not. There is a very good article in a recent issue of the *Eastern European Report* which listed a number of East European officials who have gone to jail for accepting rather minor gratuities, and the amounts of money paid by the Western firms to get their representatives out of an East European jail.

MR. CONNER: I think, though, that answer should be tempered by saying that is probably a compliment to Control Data and to their lawyers, because that hasn't been the experience of some other Western businessmen. I think it may be that if you refuse at the beginning and you keep your virginity, you keep it; but if the word gets out that you will pay, then you will pay through the nose.

MR. McELROY: I would also point out that it is common to pay for rather minor things like, for instance, it is common transportation and living costs when these people come to the West when there is a real business purpose and the giving of relatively minor gifts, such as pens, and so on.

