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§ 3:1 Formality as to structure and content

There is a formality to a joint venture contract in China that is dictated both by law and practice. The law requires that in general, certain matters must be addressed in a joint venture contract.

Article 11: A joint venture contract shall include the following main items:

- (1) the names, the countries of registration, the legal addresses of parties to the joint venture, and the names, positions and nationalities of the legal representatives thereof;
- (2) name of the joint venture, its legal address, purpose and the scope and scale of business;
- (3) total amount of investment and registered capital of the joint venture, amount, proportion and forms of investment to be contributed by each party to the joint venture, the time limit for contributing investment, stipulations concerning incomplete contributions, and assignments of investments;
- (4) the proportion of profit to be shared and losses to be borne by each party;
- (5) the composition of the board of directors, the distribution of the number of directors, and the responsibilities, powers and means of employment of the general manager, deputy general manager and high-ranking managerial personnel;
- (6) the main production equipment and technology to be adopted and their source of supply;
- (7) the ways and means of purchasing raw materials and selling finished products;
- (8) principles governing the handling of finance, accounting and auditing;
- (9) stipulations concerning labor management, wages, welfare, and labor insurance;
- (10) the duration of the joint venture, its dissolution and the procedures for liquidation;
- (11) the liabilities for breach of contract;

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(12) way and procedures for settling disputes between the parties to the joint venture; and

(13) the language(s) used for the contract and conditions for putting the contract into force.

The annex(es) to the contract shall be equally authentic as the contract itself.¹

Not only are these requirements as to structure contained in the joint venture law, the approval authority that must approve the joint venture prior to its establishment, reviews the contract to confirm that the legal requirements have been—at least minimally—addressed.

Probably a more practical method of implementing this formality as to structure and content was China's introduction of a model joint venture contract at the time that the implementing regulations were introduced in 1983.² This model contract quickly became the standard against which approval authorities judged contracts submitted to them for approval and review.

Because many foreign investors found the provisions of the model contract to be both vague and slanted in favor of the Chinese party, investors quickly began to produce their own versions of the joint venture contract to cover the important issues in a manner the investors found acceptable. But while the phrasing of the provisions changed, generally to add both precision and fairness, the overall structure of the contract tended to follow the outline form of the model contract. The distinct advantage of following the structure of the model contract, if not its content, was that the approval authority was more likely to review the document quickly and not send the contract back for revision.

The reform of the investment process in 2004 has contributed to more flexibility in the form of joint venture contracts. Since the investors are now required to approach the NDRC or the local planning authority for verification of their project's investment parameters before submitting their joint venture documentation

[Section 3:1]

¹Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment, promulgated by the State Council on Sept. 20, 1983, as amended on Jan. 1, 1986, Dec. 21, 1987, and Aug. 1, 2001 (the "Joint Venture Implementing Regulations"), Art. 11 (see Appendix D). It should be noted that the 1983 text required a statement with regard to the ratio of products to be exported and arrangements made to cover foreign currency receipts and expenditures.

²Model Contract for Joint Ventures Using Chinese and Foreign Investment (Ministry of Foreign Economic Relations, Sept 1983), Commercial Business and Trade Laws: People's Republic of China, Vol. III, Booklet 27 (New York: Oceana Publications, 1987), p. 5.

to the approval authority for approval,³ the most important aspects of the approval occur before the documentation is reviewed. It appears therefore that MOFCOM currently does not examine the wording of the joint venture documentation with the same rigidity as it once did.

§ 3:2 The parties

As with any contract, a China joint venture contract must name and provide some description of the parties to the contract simply for the purposes of identification. The Joint Venture Implementing Regulations require that the contract set forth the “the names, the countries of registration, the legal addresses of parties to the joint venture, and the names, positions and nationalities of the legal representatives thereof.”¹

§ 3:3 The parties—The Chinese party

The names of Chinese enterprises reveal more information than do the names of Western companies. Only certain companies may use the word “national” in their name and, if a company has national, China, or similar characters in its name, its formation must have been approved by the Administration of Industry and Commerce at the Central Government level.¹ Similarly, a name preceded by or containing a provincial designation must be approved by the provincial administration of industry and commerce and, if the name contains a municipality’s name, it must be approved by the municipal administration of industry and commerce. The name of a Chinese enterprise therefore identifies the level of the Administration of Industry and Commerce to which it reports and by which it is periodically inspected. Together with the enterprise’s address, one can determine the specific office of the Administration of Industry and Commerce that will maintain records on the enterprise. The name of the enterprise should also reveal whether the company is incorpo-

³Provisional Measures for the Administration of the Verification and Approval of Foreign Invested Projects, National Development and Reform Commission, Order [2004] No. 22 Oct. 9, 2004, Art. 5 (see Appendix D).

[Section 3:2]

¹Joint Venture Implementing Regulations, Art. 14(1). See, as an example of such a clause, Art. 2.1 of Appendix A attached.

[Section 3:3]

¹Implementing Procedures for the Administration of the Registration of Enterprise Names (Revised), State Administration of Industry and Commerce, originally issued Dec. 8, 1999 and revised and issued June 14, 2004, eff. July 1, 2004, Art. 5 (herein “Administrative Regulations on Names”) (see Appendix D).

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rated under The Company Law and whether it is a joint stock company or a limited liability company.²

One of the items that should appear in the section of the joint venture contract containing the parties' names is the business license number of the enterprise. All entities in China are required to have a business license—literally a permission to engage in business—that is issued by the Administration of Industry and Commerce. The corporate or enterprise records of a company will be held in a file with this number at the Administration of Industry and Commerce office that supervises its business.

The law also requires that the legal representative of the enterprise be listed, which would include the individual's name, title and nationality. The legal representative exercises considerable authority within a Chinese enterprise and normally has the power to bind the entity. The legal representative is of sufficient importance that his or her name must be registered with the Administration of Industry and Commerce along with a copy of his or her signature.³ Moreover, the appointment of a legal representative is subject to the approval of the Administration of Industry and Commerce and the law prohibits certain individuals, such as bankrupts and convicted criminals from serving as the legal representative of an enterprise.⁴ Along with the considerable powers entrusted to a legal representative come heavy responsibilities; according to the law, the legal representative may be held personally liable if an enterprise fails to pass its annual inspection by the Administration of Industry and Commerce.⁵

§ 3:4 The parties—Foreign party

Primarily in order to match what is said about the Chinese

²The Company Law of the People's Republic of China (adopted at the 5th Session of the Standing Committee of the 8th National People's Congress on Dec. 29, 1993; first amendment made at the 13th Session of the Standing Committee of the 9th National People's Congress on Dec. 25, 1999; second amendment made at the 11th Session of the Standing Committee of the 10th National People's Congress on Aug. 28, 2004; third amendment adopted at the 18th Session of the Standing Committee of the 10th National People's Congress and promulgated on Oct. 27, 2005, and effective as of Jan. 1, 2006), Art. 8 (see Appendix D).

³Administrative Provisions on the Registration of Legal Representatives of Enterprise Legal Persons, State Administration for Industry and Commerce, Apr. 7, 1998 and revised June 23, 1999, Art. 10 (see Appendix D).

⁴Administrative Provisions on the Registration of Legal Representatives of Enterprise Legal Persons, State Administration for Industry and Commerce, Apr. 7, 1998 and revised June 23, 1999, Arts. 3 and 4 (see Appendix D).

⁵Reply on the Issue of Whether an Enterprise Legal Representative Should Bear Personal Liability, State Administration of Industry and Commerce Gungshang Qize [2002] No. 123, June 7, 2002 (see Appendix D).

party to the joint venture, the foreign party must provide its name, state and country of incorporation and legal address.

Until recently there was little formality in the documents that were required to be submitted to establish the existence of the foreign investor. A simple signature on the joint venture contract was accepted as binding in most cases and there were scant requirements as to what the approval authority needed to see in order to approve of the investor's investment plans. This began to change in 2004, when the step in the approval process requiring verification of the project's parameters, was added. In cases of large projects submitted to the NDRC for approval, the Chinese and foreign investor have to submit their registration certificates, audited financial statements, and proof of creditworthiness.¹ Local planning authorities have the right to request such documents or other similar items. In 2006, China also added the burdensome task of notarizing and consularizing the certificate of incorporation or other identity certificate submitted by the foreign investor.² This latter requirement has begun to discourage the use of some excellent tax haven countries that do not have a Chinese embassy, such as the British Virgin Islands and the Cayman Islands.

Equally troublesome and considerably more troubling, is the requirement that the foreign investor prepare and file a power of attorney authorizing an agent in China to accept service of process on its behalf. The power of attorney must expressly authorize the agent to accept service of legal documents on behalf of the investor and state the address and method of contacting the agent. Since this document is on file with the Administration of Industry and Commerce and does not appear to be limited in any way, apparently all investors in China are now subject to suit in China on claims unrelated to their investment.³

Chinese joint venture parties generally prefer to see the

[Section 3:4]

¹Provisional Measures for the Administration of the Verification and Approval of Foreign Invested Projects, National Development and Reform Commission, Order [2004] No. 22 Oct. 9, 2004, Art. 6 (see Appendix D).

²Implementing Opinions on Several Issues Concerning the Application of the Law in the Administration of the Examination, Approval and Registration of Foreign-invested Companies, State Administration of Industry and Commerce, MOFCOM, General Administration of Customs, and State Administration of Foreign Exchange, Gong Shang Wai Qi Zi [2006] No. 81 Apr. 24, 2006 (see Appendix D).

³Implementing Opinions on Several Issues Concerning the Application of the Law in the Administration of the Examination, Approval and Registration of Foreign-invested Companies, State Administration of Industry and Commerce, MOFCOM, General Administration of Customs, and State Administration of Foreign Exchange, Gong Shang Wai Qi Zi [2006] No. 81 Apr. 24, 2006, Art. 5 (see Appendix D).

ultimate parent corporation sign a joint venture contract. They resist, although normally after lengthy negotiations will agree to, the use of special purpose subsidiaries that shield the parent company from liability for the promises contained in the contract so long as adequate explanations are given as to why the use of a subsidiary is necessary. While Chinese parties do recognize that foreign companies may wish to use a subsidiary for tax planning purposes, such a request is normally met with a request to have the obligations of the subsidiary guaranteed by the parent corporation. This is one of the earliest issues dealt with by the two parties and frequently results in the foreign investor agreeing to use its ultimate parent company as the investor. If this result is to be avoided, it is best to raise the issue in the very first discussions and any letter of intent regarding the project.

Although most Western companies do not have a legal representative with the same powers as a Chinese enterprise legal representative, they are required to name one for the purposes of complying with the law. The Chinese party will frequently insist that the Chairman of the Board of Directors of the foreign investor sign the joint venture contract, reasoning that foreign companies must be like Chinese companies where the Chairman is almost certainly the legal representative of the enterprise. Such a request can cause considerable difficulty, since most large multinationals do not make a habit of having their Chairman sign the company's contracts. This problem can be avoided if the foreign company obtains a Board of Directors resolution to empower a particular individual to negotiate and sign the joint venture contract and authorize that individual to sign as "legal representative" of the company.

There was once considerable resistance to using tax haven companies, such as companies formed in the British Virgin Islands, the Cayman Islands and other similar jurisdictions as parties to a China joint venture contract. This reluctance has changed over time, since now many PRC enterprises not only are aware of the frequent use made of such jurisdictions, but have also begun to use such tax haven companies themselves on their outbound investment work. As noted above, however, the requirement to notarize and consularize documents from the investor's home jurisdiction is reducing the popularity of the British Virgin Islands, the Cayman Islands, and other countries without consulates.

§ 3:5 The parties—Representations and warranties as to parties

The model contract contains no description of, nor representations or warranties as to, the nature, due formation, legal powers, or authorization of either party. Over time, it has become

customary to add certain very minimal representations and warranties as to the parties that are entering into the joint venture contract. It is unclear, however, what the rights and remedies of a party may be if the other party misrepresents its status or authority to proceed with the joint venture.

§ 3:6 The parties—The joint venture company as a party

While it is customary in most jurisdictions for the joint venture company, once formed, to sign the Joint Venture Contract so as to be contractually bound by its terms, this custom is not followed in China. In part, this may be due to the fact that the separate legal existence of the joint venture, as distinct from its investors, is not nearly as strong under Chinese law as it is under the laws of most developed countries. Members of the Board of Directors, for example, make a point of representing the shareholder that appointed them and are permitted to ignore what is best for the joint venture company without violating a fiduciary duty. Probably more importantly, however, is that since the joint venture company cannot possibly be in existence at the time the joint venture contract is signed, the Chinese party insists that the company cannot be a signatory. While the logic of this position falters once the venture is formed, it remains the case that the joint venture company is seldom a party to the joint venture contract.

The principal reason for insisting that the joint venture company sign the joint venture contract after the company comes into existence is to make the company subject to the arbitration clause contained in the contract. As discussed in § 4:6, most joint venture contracts contain an arbitration clause, frequently requiring the parties to arbitrate in a neutral forum outside of China. One method of avoiding the arbitration clause that apparently works in China is for the disgruntled shareholder/joint venture partner to sue the company alleging some infringement of the party's rights. For example, if the joint venture agreed to license additional technology from the foreign partner, the Chinese partner—assuming it disagreed with the decision and had been out-voted in the Board of Directors meeting—could sue the company alleging that the company's agreement to pay additional royalties impinged on its future dividends and therefore harmed the Chinese party. While there may be many defenses to such an argument, it is really a dispute between the two parties and should be decided under the provisions of the arbitration clause, rather than in a Chinese court.

§ 3:7 The parties—Joint venture company name

The joint venture contract must name the joint venture company and stipulate as to its legal address. The rules with