

- 15 The Regulations of the People's Republic of China on the Administration of Registration of Companies, promulgated by the State Council on 24 June 1994 and amended by the State Council on 18 December 2005.
- 16 For example, the State Administration for Industry and Commerce is responsible for the registration of foreign-invested companies.
- 17 A controlling shareholder is a shareholder whose capital contribution accounts for 50 percent or more of the total capital of a limited liability company or whose shares account for 50 percent or more of the total share capital of a company limited by shares. If a shareholder's capital contribution or shares account for less than 50 percent, but its voting rights can greatly influence the resolutions of a shareholders' meeting, such shareholder will also be deemed a controlling shareholder.
- 18 An actual controller is any person who is not a shareholder, but can control the company's acts through investment relationships, agreements, or other arrangements.
- 19 Affiliate relationship refers to the relationship between a company's controlling shareholder, actual controllers, directors, supervisors, or high-ranking managerial personnel and an enterprise that is directly or indirectly controlled by them, and any other relationships that may cause the company's interests to be transferred, except for the relationship between state-controlled enterprises that are commonly controlled by the state.
- 20 The Enterprise Bankruptcy Law of the People's Republic of China, adopted at the 23rd Session of the Standing Committee of the 10th National People's Congress on 27 August 2006.
- 21 The Antimonopoly Law of the People's Republic of China, adopted at the 29th Session of the Standing Committee of the 10th National People's Congress on 30 August 2007.
- 22 The Enterprise Bankruptcy Law of the People's Republic of China (for Trial Implementation), adopted at the 18th Session of the Standing Committee of the 6th National People's Congress on 2 December 1986.
- 23 "Mutual-benefit debts" are debts incurred after the people's court has accepted the bankruptcy application, such as debts incurred as a result of performance, at the request of the administrator or the debtor, by the other party to a contract that has not been completely performed by both parties and remuneration for labor services and social security premiums paid to continue the debtor's business.
- 24 Article 153(1) of the 1991 Civil Procedure Law provides that the court of second instance should: "(i) dismiss the appeal and affirm the judgment of the court of first instance if the original judgment is based on clearly ascertained facts and correct application of law, ... (iii) remand the case for retrial or amend the original judgment if the original judgment is based on erroneous or unclear facts or insufficient evidence."
- 25 Article 153(1)(i) of the 1991 Civil Procedure Law provides that the court of second instance should dismiss the appeal and affirm the judgment of the court of first instance if the original judgment is based on clearly ascertained facts and correct application of law.
- 26 Article 4 of the General Principles of the Civil Law states that in civil activities, the principles of voluntariness; fairness; compensation for equal value; and honesty, loyalty and trust should be followed.
- 27 Article 183 of the Company Law provides that if the operations and management of the company encounter serious difficulties, the continuous existence of the company will result in significant losses to the shareholders, but no alternative resolution means may be available, the shareholder(s) holding 10 percent or more of the voting rights may request the court to dissolve the company.

3 Foreign investment enterprises

For companies that want to expand overseas, an assortment of investment vehicles are at their disposal, depending on their business strategies, financial means, human resources, familiarity with the foreign market, and the legal environment of the host country. A manufacturer may just want to export its products, in which case, it will have to commit the least amount of resources and assume the least amount of risk. At the other end of the spectrum, the manufacturer may want to establish a wholly owned subsidiary in the foreign country, which will engage in production, distribution, and after-sale services. In that case, the manufacturer will have to commit abundant resources and will be likely to encounter the greatest amount of risk. Taking the middle course, the manufacturer may find a local partner to form a joint venture, with the local partner taking responsibilities for sale and distribution while it concentrates on production. In such a case, the manufacturer will share control, profits, and risks with the local partner.

Since China opened its door to the outside world in 1979, there have been five major vehicles for foreign investors to do business in China: representative office, branch, Sino-foreign equity joint venture, Sino-foreign cooperative joint venture, and wholly foreign-owned enterprise. Without the status of Chinese legal persons, the first two investment vehicles are preparatory in nature and involve a relatively limited scope and amount of business activities. The latter three types of business entities, which are collectively referred to as foreign investment enterprises (外商投资企业) (FIEs), are Chinese legal persons and the core instruments for foreign direct investment in China. Starting from the mid-1990s, China has also allowed foreign investors to establish foreign companies limited by shares. This relatively new investment vehicle has been gaining popularity among foreign investors. Accordingly, this chapter highlights the important legal provisions on these six investment vehicles.

Over the years, China has enacted an array of laws, administrative regulations, and government rules on representative office, branch, and FIEs in order to attract foreign capital, technology, and management expertise. Apart from general legal norms, the State Council and various ministries or departments have also enacted industry-specific regulations and rules, while governments of provinces, autonomous regions, municipalities directly under the central government, and SEZs have passed local regulations impacting on FIEs in their respective areas.

For example, there are industry-specific regulations or rules on foreign-invested financial institutions, insurance companies, telecommunications enterprises, shipping companies, and leasing companies. Moreover, Shanghai, Tianjin, Shenzhen, Guangdong, Qinghai, etc. have enacted legal provisions on FIEs established under their jurisdictions. Since this chapter focuses on discussing national legal norms on FIEs, foreign investors should also consider industry-specific and local regulations or rules when they make decisions to invest in China. Furthermore, it is noteworthy that laws, administrative regulations, and government rules on FIEs, in general, are also applicable to enterprises funded by overseas Chinese from Hong Kong, Macau, and Taiwan.

Representative office of a foreign enterprise

The governing rules on representative offices of foreign enterprises are the Provisional Regulations on the Administration of Resident Representative Offices of Foreign Enterprises,¹ the Measures on the Administration of Registration of Resident Representative Offices of Foreign Enterprises,² and the Detailed Implementation Rules on the Approval and Administration of Resident Representative Offices of Foreign Enterprises in China.³ These three pieces of legislation outline the requirements and procedures for the establishment, registration, extension, modification, and termination of representative offices of foreign enterprises in China. The following is a succinct account of the representative office.

To establish a resident representative office, the foreign enterprise (外国企业) must be lawfully registered in its home country; have a sound business reputation, provide authentic and reliable documents and materials as required by the law, and have gone through the application formalities. However, to apply for approval, the foreign enterprise cannot go to the government directly. Instead, the foreign enterprise must entrust a company that has been approved by the government to engage in foreign economic and trade business, or a foreign-economic-and-trade organization or a foreign-affairs-service unit approved by the government, with the task of going through the application formalities.

In applying for approval, the foreign enterprise must submit the following documents and materials:

- 1 a written application signed by the chairperson of its board of directors or its general manager, providing a brief introduction of the enterprise, the purpose of establishing a representative office, the name of the representative office, the names of the chief representative and representatives, the business scope of the representative office, the duration of the representative office, and the location of the representative office;
- 2 a copy of the business certificate issued by the relevant authorities of its home country;
- 3 the original certificate of creditworthiness issued by a bank with which it does business;
- 4 the power of attorney signed by the chairperson of its board of directors (the

executive director if there is no board) or the general manager regarding the appointment of the chief representative and representatives,⁴ the resumes of the representatives, and copies of proof of their identity;

- 5 a completed "Application Form for the Establishment of Resident Representative Office of Foreign Enterprise" and a completed "Application Form for Personnel of Resident Representative Office of Foreign Enterprise"; and
- 6 any other materials deemed necessary by the examination-and-approval organ.

With respect to traders, manufacturers, contractors, consulting companies, advertising companies, leasing companies, investment companies, etc., the examination-and-approval organ is the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) (now the Ministry of Commerce (MOC)) or its office in the relevant province, autonomous region, municipality directly under the central government, or separately planned city.⁵

Within 30 days of approval, the chief representative must register with the SAIC or its office in the relevant province, autonomous region, municipality directly under the central government, or separately planned city (local AIC). The major items to be registered are the name of the representative office, the address of the representative office, the number of representatives and their names, the business scope of the representative office, and the term of the representative office. To apply for registration, the foreign enterprise should complete the "Application Form for the Registration of Resident Representative Office of Foreign Enterprise" and submit the certificate of approval, items 1 to 4 of the list of materials required for application, and any other materials as required by the AIC. The date of registration is the founding date of the representative office. After obtaining the certificate of approval, the certificate of registration, and work permits (formerly called "certificates of representatives"), the representative office should also go through the necessary formalities with the public security, banking, customs, and tax authorities.

The maximum term of a representative office is three years, starting from the date of the issue of the approval certificate. If the representative office wants to continue operations after the expiration of its term, it can apply for an extension, via the original entrusted entity, 60 days before it expires. The certificate of registration is valid for one year and must be renewed within the 30 days prior to its expiration by submitting an annual report on the representative office's business operations and an application form. If the representative office obtains an extension after the expiration of its term, it will have to submit the new certificate of approval issued by the original examination-and-approval organ and complete an application form for registration of extension. During its term, if the representative office has any changes to its name, responsible personnel, scope of business, duration, or address, it must obtain approval from the original examination-and-approval organ and apply for registration of change. If the representative office wants to change a representative, it should also submit the power of attorney issued by the foreign enterprise and the resume and proof of identity of the new representative.

The name of the representative office should include the following: "country + enterprise name + city name + representative office." The representative office can conduct, on behalf of the foreign enterprise and within its scope of business, such indirect business activities as business liaison, product introduction, market studies, and technical exchanges. In any event, the foreign enterprise assumes legal liability for all the business activities of the representative office. Given these constraints on business activities, a foreign enterprise establishes a representative office mainly to obtain a better understanding of the Chinese market or introduce itself to potential customers.

When the representative office terminates upon or prior to the expiration of its term, it must, via the original entrusted entity, submit an application for cancellation signed by the chairperson of its board of directors or its general manager and report to the original examination-and-approval organ for the record 30 days in advance, and after settling its debts, taxes payable, and other relevant matters, go through the formalities of cancellation of registration, customs record, etc. Similarly, if the foreign enterprise has been declared bankrupt, the representative office must settle its debts and taxes payable and apply for cancellation of registration.

Branch of a foreign company

Articles 192 to 198 of the Company Law govern the establishment of branches of foreign companies. A foreign company, which is a company established outside China in accordance with the law of a foreign country, may establish a branch or branches in China to engage in production and operations. To set up a branch, the foreign company shall file an application with the relevant Chinese organ-in-charge together with its articles of association, the registration certificate issued by its home country, and any other relevant documents. Having secured the required approval, the company must register with and obtain a business license from the AIC.

The foreign company must appoint a representative or agent in China, who will be in charge of the branch, and shall allocate to the branch funds appropriate for the business in which it is engaged. The branch must indicate in its name the nationality of the foreign company and what type of liability the foreign company has. The articles of association of the foreign company must be available at the branch. Compared with a representative office, the branch of a foreign company is allowed to engage in a broader scope of business activities. However, since the branch of a foreign company does not have the status of a Chinese legal person, the foreign company assumes civil liabilities for the business activities of the branch. When a foreign company closes down its branch in China, it must repay the debts of the branch and conduct liquidation in accordance with the law. The property of the branch cannot be transferred overseas before its debts are paid off.

Equity joint venture

With the passage of the Law on Sino-Foreign Equity Joint Ventures (Equity Joint Venture Law) in 1979, China opened its door to the outside world. To date, the

Equity Joint Venture Law has been revised twice: in 1990 and 2001.⁶ Coupled with the Regulations for the Implementation of the Law on Sino-Foreign Equity Joint Ventures,⁷ the Equity Joint Venture Law provides the basic legal framework for equity joint ventures in China. Nevertheless, China has also passed a series of administrative regulations and government rules on various topics relating to FIEs, which are applicable to equity joint ventures, cooperative joint ventures, and wholly foreign-owned enterprises. Accordingly, the issues raised below are based on the relevant provisions in the Equity Joint Venture Law and its implementation regulations. If the provisions are taken from other legislative sources, they will be so noted.

Requirements

The Equity Joint Venture Law allows foreign companies, enterprises, economic organizations, or individuals (the foreign party) to form Sino-foreign equity joint ventures (中外合资经营企业) with Chinese companies, enterprises, or economic organizations (the Chinese party). An equity joint venture is to be established in the form of a limited liability company, and the capital contributed by the foreign party cannot be less than 25 percent of the registered capital of the joint venture. The registered capital (注册资本) refers to the total amount of capital contributions of the parties that is to be registered with the AIC for the establishment of the joint venture. During its term, the joint venture cannot reduce the registered capital. If it is necessary to reduce the registered capital due to changes in the total amount of investment and production or operations scale, the joint venture must obtain the approval of the examination-and-approval organ and go through the formalities of change of registration with the AIC.

Additionally, the proportion of the registered capital to the total amount of investment (投资总额), which is the sum of capital construction funds and cash flow needed for production as stipulated in the joint venture contract and the articles of association (including loans), should be as follows:

- 1 If the total amount of investment is US\$3 million or less, the registered capital should be at least 70 percent of the total amount of investment.
- 2 If the total amount of investment is more than US\$3 million but US\$10 million or less, the registered capital should be at least 50 percent of the total amount of investment (if the total amount of investment is less than US\$4.2 million, the registered capital cannot be less than US\$2.1 million).
- 3 If the total amount of investment is more than US\$10 million but US\$30 million or less, the registered capital should be at least 40 percent of the total amount of investment (if the total amount of investment is less than US\$12.5 million, the registered capital cannot be less than US\$5 million).
- 4 If the total amount of investment is more than US\$30 million, the registered capital should be at least 33 percent of the total amount of investment (if the total amount of investment is less than US\$36 million, the registered capital cannot be less than US\$12 million).⁸

Investment may be made in the form of cash, in-kind contributions (machinery, equipment, and materials), buildings, factory premises, industrial property rights, proprietary technologies, or the right to use a site. If the foreign party contributes cash in foreign currency or the Chinese party contributes cash in RMB, it shall be converted into RMB or foreign currency in accordance with the joint venture contract based on the standard exchange rate announced by the People's Bank of China on the day of payment. Apart from the right to use a site, the value of each contribution is to be appraised by the parties through joint consultation or can be evaluated by a third party agreed upon by the parties. If the foreign party contributes machinery, equipment, and materials, they must be necessary for the production of the joint venture, and their prices must not be higher than the current international market prices for similar machinery, equipment, or materials. If the foreign party contributes an industrial property right or a proprietary technology, it must be capable of improving notably the performance and quality of existing products and raising productivity, or it should be capable of producing remarkable savings in raw materials, fuel, or power. In any event, the machinery, equipment, materials, industrial property rights, etc. contributed by the foreign party is subject to the approval of the examination-and-approval organ.

If a joint venture needs to use a site, it must file an application with the municipal-level or county-level land-administration department of the place where it is located. After obtaining the approval, the joint venture shall sign a contract, stipulating the area and location of the site, the purpose of use, the duration of the contract, the site-use fee, etc. Where the right to use a site is not part of the Chinese party's capital contribution, the joint venture will be required to pay a site-use fee to the government. If the right to use a site is part of the Chinese party's capital contribution, the monetary value of this right will be the same as the site-use fees required for similar sites. The standards of site-use fees shall be determined by the people's government of the province, autonomous region, or municipality directly under the central government where the joint venture is located with reference to such factors as the purpose of use, geographical and environmental conditions; expenses for requisition, demolition, and resettlement; and the joint venture's requirements with respect to infrastructure. Site-use fees as part of the investment of the Chinese party are not subject to adjustment during the contract term.

The parties must pay in full their respective contributions by the deadlines stipulated in the joint venture contract. If a party delays making a payment or has not paid in full, it shall pay interest for the arrears or a compensation for loss as stipulated in the joint venture contract. After the parties have made all the contributions, an accountant registered in China shall verify the contributions and produce a certificate of capital verification, on the basis of which the joint venture will issue certificates of investment.

If an equity joint venture is engaged in an investment project encouraged or permitted by the Chinese government, it may or may not have a fixed term. However, a joint venture must have a fixed term if it does business in one of the following industries or situations:

- 1 services, such as hotels, apartments, office buildings, recreation and entertainment, food and beverages, taxis, maintenance, and consultation;
- 2 land development and real estate;
- 3 prospecting and exploitation of natural resources;
- 4 investment projects restricted by the state; or
- 5 contracts requiring fixed terms as stated in other laws and regulations.⁹

Where an equity joint venture is required to have a fixed term, the term may be set differently, depending on the industry or the circumstances. An equity joint venture may apply for an extension with the examination-and-approval organ six months prior to the expiration of its term. The examination-and-approval organ will approve or reject the application within one month of the receipt of the application.

Rights and liabilities

In an equity joint venture, the parties share profits and bear risks and losses in proportion to their respective contributions to the registered capital. Before distribution of after-tax profits, the joint venture should allocate to the reserve fund, staff-and-worker bonus and welfare fund, and enterprise development fund. The proportion of allocation is to be determined by the board of directors. Money in the reserve fund can be used to cover losses, or, with the approval of the examination-and-approval organ, to increase the joint venture's capital for expansion of production. Nonetheless, profits must not be distributed before the losses of the previous year(s) have been recovered.

If one party wants to transfer all or part of its equity, it must obtain the consent of all the other parties and the approval of the examination-and-approval organ, as well as going through the formalities of change of registration. The terms of the transfer given to a third party cannot be more favorable than those given to the other parties to the joint venture, and the other parties have the right of first refusal. Having fulfilled its obligations prescribed by the law or stipulated in agreement or contract, the foreign party may remit abroad its net profit and any funds it receives upon the expiration or discontinuation of the joint venture in the currency as specified in the joint venture contract. The wages and other legitimate incomes of expatriates may be remitted abroad after individual income taxes have been paid.

For years, if the foreign party reinvested its net profit in China, it might apply for a refund of that portion of income tax paid. However, the recently passed Enterprise Income Law, which is discussed in Chapter 8, has repealed the preferential tax treatments to foreign investors, including the two-year exemption followed by a three-year 50 percent deduction of enterprise income tax (the so-called two-plus-three tax holiday for manufacturing FIEs), the maximum 50 percent deduction of enterprise income tax available to high-technology or export-oriented FIEs, the reinvestment refund available to foreign investors and foreign-invested holding companies, and the refund on the local portion of the enterprise income tax or local

income tax granted by the government of a province or a municipality directly under the central government.

Furthermore, an equity joint venture may establish branches outside China. When a joint venture needs to purchase machinery, equipment, raw materials, fuel, parts, office supplies, transportation vehicles, etc., it has the right to decide whether to buy them in China or from abroad. Equity joint ventures are encouraged to sell products in the international market. They may export products on their own or sell products through their overseas sales agents or China's foreign-trade companies on a commission basis. As regards prices for materials purchased in China and fees charged for such services as water, electricity, gas, heating, transportation of goods, labor, engineering design, consultation, and advertisement, equity joint ventures shall be treated equally with domestic enterprises. In addition, joint ventures are required to pay taxes in accordance with tax laws and regulations, which are discussed in Chapter 8. Nevertheless, taxes on machinery, equipment, parts, raw materials, etc. imported by the joint venture as part of the foreign party's investment or for production of export goods may be exempted or reduced.

Application procedure

To establish an equity joint venture, the parties must obtain approval from the MOFTEC (now the MOC). However, the State Council also delegates to the people's governments in provinces, autonomous regions, and municipalities directly under the central government as well as relevant departments under it the power to examine and approve the establishment of equity joint ventures that meet two requirements:

- 1 the total amount of investment should be within the approval limit as set by the State Council, and the source of capital of the Chinese party must have been ascertained; and
- 2 additional allocations of raw materials by the state must not be needed, and the national balance of fuel, power, communications and transportation, foreign trade export quotas, etc. will not be affected.

If the prospective joint venture meets these two requirements, it may obtain approval from one of the examination-and-approval organs and report to the MOC for the record.

In applying for approval, the parties must jointly submit the following documents to the examination-and-approval organ:

- 1 an application for the establishment of a joint venture;
- 2 a feasibility study report jointly prepared by the parties;
- 3 the joint venture agreement, joint venture contract, and articles of association signed by representatives authorized by the parties;
- 4 a list of candidates nominated by the parties for the posts of chairperson, vice-chairperson, and members of the board of directors; and

- 5 any other documents as required by the examination-and-approval organ.

Specifically, the joint venture agreement (合营企业协议) refers to the document agreed upon by the parties with respect to certain major points and principles governing the establishment of the joint venture. The joint venture contract (合营企业合同) refers to the document concluded by the parties with respect to their mutual rights and obligations. The articles of association (合营企业章程) refer to the document agreed upon by the parties delineating the objectives, organizational principles, management methods, etc. of the joint venture in accordance with the principles stipulated in the joint venture contract. If the joint venture agreement and joint venture contract have conflicts, the joint venture contract will prevail. If the parties agree to conclude only the joint venture contract and the articles of association, the joint venture agreement may be omitted.

The joint venture contract is the centerpiece of all the required documents. The major items to be included in the joint venture contract include:

- 1 the names, countries of registration, and legal addresses of the parties, and the names, posts, and nationalities of their legal representatives;
- 2 the name, legal address, objective(s), business scope, and scale of the joint venture;
- 3 the joint venture's total amount of investment and registered capital, the amount, proportion, form, and time limit of each party's investment, and provisions regarding unpaid contributions and transfer of equity;
- 4 the proportion to be borne by each party with respect to profit distribution and liability for loss;
- 5 the composition of the board of directors, the distribution of the number of directors, and the responsibilities, powers, and means of appointment of the general manager, deputy general managers, and other senior managerial personnel;
- 6 the main production equipment and technology to be adopted and their sources of supply;
- 7 the methods of purchasing raw materials and of selling products;
- 8 the principles governing the treatment of finance, accounting, and auditing;
- 9 provisions on labor management, wages, welfare, labor insurance, etc.;
- 10 the duration of the joint venture, its dissolution, and the liquidation procedure;
- 11 liabilities for breach of contract;
- 12 the means and procedure for resolving disputes between the parties; and
- 13 the language used for the joint venture contract and the conditions for putting the contract into effect.

In this connection, it is noteworthy that the formation, validity, interpretation, performance of the joint venture contract and the resolution of any disputes over it are to be governed by Chinese law. Likewise, the articles of association of an equity joint venture should contain:

- 1 the name and legal address of the joint venture;
- 2 the objective(s), business scope, and duration of the joint venture;
- 3 the names, countries of registration, and legal addresses of the parties to the joint venture, and the names, posts, and nationalities of their legal representatives;
- 4 the total amount of investment and registered capital of the joint venture, the amount and proportion of each party's capital contribution, provisions on transfer of equity, and the proportion to be borne by each party with respect to profit distribution and liability for loss;
- 5 the composition, powers, and rules of procedure of the board of directors, the term of office of directors, and the duties of the chairperson and vice-chairperson of the board;
- 6 the establishment of management organs and their rules for handling affairs, the responsibilities of the general manager, deputy general managers, and other senior managerial personnel, and the means to appoint and dismiss these officers;
- 7 the principles governing the systems of finance, accounting, and auditing;
- 8 the provisions on dissolution and liquidation; and
- 9 the procedure for amending the articles of association.

Thus, the contents of the joint venture contract and the articles of association are largely the same. Moreover, the joint venture agreement, joint venture contract, and articles of association take effect upon the approval of the examination-and-approval organ.

Having received all the required documents, the examination-and-approval organ must approve or disapprove the joint venture in three months. Within one month of the receipt of the certificate of approval, the parties must apply for registration with the relevant AIC. The date of the issue of the business license is the founding date of the equity joint venture. During its term, if the equity joint venture has major changes, it must obtain approvals from the examination-and-approval organ and go through the formalities of change of registration with the AIC.

Corporate governance

In an equity joint venture, the board of directors is the highest organ of power. The number of directors must be at least three, and the allocation of the number of directors is to be determined by the parties through consultation and with reference to the proportion of capital contribution. Each party is responsible for appointing and replacing its director(s). The term of office of a director is four years, and each party may reappoint its director(s). The chairperson of the board of directors is the legal representative of the joint venture. The chairperson and vice-chairperson of the board of directors shall be chosen by the parties through consultation or be elected by the board of directors. If the chairperson of the board of directors is from one side, the vice-chairperson must be from the other side.

The board of directors must meet at least once a year. Interim meetings may be

convened if one-third or more of the directors propose. A board meeting can be held only if two-thirds or more of the directors are present. If a director is unable to attend, he or she may send a proxy. The powers of the board of directors must be provided in the articles of association. As a rule, the board of directors shall decide on the following important issues:

- 1 plans for development, production, and business operations;
- 2 budget;
- 3 distribution of profits;
- 4 labor and wage plans;
- 5 termination of operations;
- 6 the appointment, powers, and remuneration of the general manager, deputy general managers, chief engineer, chief accountant, and auditor; and
- 7 the increase or reduction of the registered capital.

For the amendment of the articles of association, termination and dissolution of the joint venture, expansion and reduction of the registered capital, and merger or division of the joint venture, there must be a unanimous vote of all the attendees. Resolutions on other matters shall be made in accordance with the rules of procedure as provided in the articles of association.

A joint venture must establish a management organ that is responsible for the daily operations of the joint venture. The board of directors must appoint one general manager and several deputy general managers. The posts of general manager and deputy general manager are to be held separately by each side. The general manager is to implement the resolutions of the board of directors and is responsible for the daily management of the joint venture. Within the powers authorized by the board of directors, the general manager represents the joint venture externally and may appoint or dismiss subordinates. Directors may concurrently serve as the general manager, deputy general managers, and other senior managerial personnel of the joint venture. However, the general manager and deputy general managers must not concurrently serve as the general manager or deputy general managers of other economic entities and must not engage in any competitive activities of other economic entities against the joint venture.

Dissolution and liquidation

An equity joint venture will be dissolved under one of the following circumstances:

- 1 expiration of the term of the joint venture;
- 2 inability to continue operations due to heavy losses;
- 3 inability to continue operations due to the failure of one party to fulfill its obligations as stipulated in the joint venture agreement, joint venture contract, and articles of association;
- 4 inability to continue operations due to heavy losses caused by *force majeure*, such as natural disaster and war;

- 5 failure to achieve the objectives of the joint venture and no prospects for future development; or
- 6 occurrence of other causes for dissolution as stipulated in the joint venture contract and the articles of association.

In the cases of 2, 4, 5, and 6, the board of directors shall apply to the examination-and-approval organ for approval. In the case of 3, the non-breaching party shall apply to the examination-and-approval organ for approval, and the breaching party will be liable for compensation due to losses.

Upon dissolution, the joint venture must be liquidated. For years, the liquidation of an equity joint venture was governed by the Measures on the Liquidation of Foreign Investment Enterprises.¹⁰ Nonetheless, in 2008, the State Council repealed this set of measures on the basis that the 2005 Company Law had replaced them.¹¹ Accordingly, the liquidation of an equity joint venture is to be conducted in accordance with the Company Law, whose provisions on liquidation are discussed in Chapter 2. An equity joint venture is liable for its debts to the extent of all of its assets. After all the debts are paid off, the residual property will be distributed among the parties in proportion to their respective investments, unless otherwise provided by the joint venture agreement, joint venture contract, or articles of association. Furthermore, the equity joint venture shall apply for cancellation of registration with the AIC and the tax authority.

Cooperative joint venture

Apart from equity joint ventures, foreign investors may also invest in China by means of Sino-foreign cooperative joint ventures (中外合作经营企业), which have also been translated as Sino-foreign contractual joint ventures. The Law on Sino-Foreign Cooperative Joint Ventures (Cooperative Joint Venture Law)¹² and the Detailed Rules for the Implementation of the Law on Sino-Foreign Cooperative Joint Ventures¹³ comprise the regulatory framework for cooperative joint ventures. As mentioned above, other administrative regulations and government rules on FIEs apply to cooperative joint ventures. Thus, the issues dealt with below are based on the relevant provisions in the Cooperative Joint Venture Law and its implementation rules. If the provisions are taken from other legislative sources, they will be so noted.

Requirements

The Cooperative Joint Venture Law allows foreign enterprises, economic organizations, or individuals (the foreign party) to form cooperative joint ventures with Chinese enterprises or other economic organizations (the Chinese party). A cooperative joint venture can be a legal person or non-legal person. As mentioned in Chapter 2, a legal person is established in accordance with the law; has necessary property and operating funds; has a name, organizational structure, and site; and can assume civil liability independently. If a cooperative joint venture meets the

requirements of a legal person, it will be a limited liability company. In a non-legal-person cooperative joint venture, the parties operate as separate entities and bear liabilities independently, even though they may agree to jointly own all or part of the investments (投资)¹⁴ or cooperative means (合作条件).¹⁵ However, the accumulated property of a non-legal-person cooperative joint venture is to be jointly owned by the parties. In essence, a non-legal-person cooperative joint venture is akin to a contractual arrangement between the parties.

If the cooperative joint venture is a legal person, the foreign party shall generally contribute not less than 25 percent of its registered capital. If the cooperative joint venture is not a legal person, the MOFTEC (now the MOC) will prescribe specific requirements for the parties' investments and cooperative means. Indeed, the MOFTEC has explained that the foreign party's investment in a non-legal-person cooperative joint venture must not be less than 25 percent of the total amount of investment made by the Chinese and foreign parties.¹⁶ In addition, the non-legal-person cooperative joint venture should register the investments or cooperative means contributed by the parties with the AIC.

Investments or cooperative means can be made in the form of cash, in-kind contributions, land use rights, industrial property rights, non-patented technologies, or other property rights. If the cooperative means furnished by the Chinese party are state-owned, they should be appraised in accordance with laws and administrative regulations. The parties must pay in full their investments or furnish the cooperative means on schedule. After the parties have made all the contributions, an accountant registered in China or a relevant organ shall verify the contributions and produce a certificate of capital verification, on the basis of which the cooperative joint venture will issue certificates of investment. The parties cannot mortgage or use as collateral in other situations their investments or cooperative means. During its term, the cooperative joint venture cannot reduce its registered capital. If it is necessary to reduce the registered capital due to changes in the total amount of investment and production or operations scale, the joint venture must obtain the approval of the examination-and-approval organ. The rules regarding the proportion of the registered capital to the total amount of investment in an equity joint venture also apply to cooperative joint ventures.¹⁷

The duration of a cooperative joint venture shall be determined by the parties through consultation and stipulated in the joint venture contract. There are no minimum and maximum requirements for the term of a cooperative joint venture. If the parties agree to extend the term of the joint venture, they must apply to the examination-and-approval organ 180 days before its expiration. The examination-and-approval organ will approve or disapprove the application within 30 days of its receipt. Where the foreign party has fully recovered its investment upon the expiration of the cooperative joint venture, the term of the joint venture shall not be extended. However, if the foreign party increases its investment and all the parties have reached a consensus, the cooperative joint venture may apply for an extension.

Rights and liabilities

As a limited liability company, a legal-person cooperative joint venture is liable for its debts to the extent of all of its assets. Likewise, the parties are liable to the cooperative joint venture to the extent of their respective investments or cooperative means, unless otherwise provided by the joint venture contract. Indeed, the parties to a cooperative joint venture must stipulate in the joint venture contract such matters as investments made or cooperative means furnished by the parties, time limits for making investments or providing cooperative means, distribution of profits or products, sharing of risks and losses, management style, and ownership of the joint venture's property upon the expiration of its term. In other words, the parties to a legal-person cooperative joint venture may share profits and products as well as bear risks and losses in accordance with the joint venture contract.

Furthermore, if the parties stipulate in the joint venture contract that all the fixed assets of the joint venture will be given to the Chinese party upon the expiration of its term, they may also provide the means for the foreign party to recover its investment during the existence of the joint venture. Specifically, the foreign party may recover its investment during the term of the joint venture in one of the following ways:

- 1 Based on the distribution of investments or cooperative means, the parties may agree in the joint venture contract to increase the profit sharing ratio of the foreign party.
- 2 Upon examination and approval by the finance and tax authorities in accordance with relevant tax provisions, the foreign party may recover its investment before income tax is paid by the joint venture.
- 3 The foreign party may use other means of investment recovery approved by the examination-and-approval organ as well as the finance and/or tax authorities.¹⁸

Nonetheless, the foreign party cannot recoup its investment in advance if the losses of the cooperative joint venture have not been recovered. Where the foreign party may recover its investment during the term of the joint venture, both the Chinese and foreign parties are responsible for the debts of the cooperative joint venture in accordance with relevant laws and the stipulations in the joint venture contract.

If one party wants to transfer all or part of its rights in the cooperative joint venture to another party or an outsider, it must obtain the written consent of all the other parties and the approval of the examination-and-approval organ. In the case of a non-legal-person cooperative joint venture, the investments and cooperative means of the parties are subject to the joint venture's unified management and use, and no party may unilaterally dispose of them without the consent of the other parties. Having fulfilled its obligations prescribed by the law or stipulated in the joint venture contract, the foreign party may remit abroad its profits, other lawful incomes, and funds it receives upon the expiration of the joint venture. The wages and other legitimate incomes of expatriates may be remitted abroad after individual income taxes have been paid.

The Chinese government encourages the establishment of export-oriented or technologically advanced production-type cooperative enterprises. When a cooperative joint venture needs to purchase machinery, equipment, raw materials, fuel, parts and components, office supplies, etc., it may buy them in China or from abroad. Cooperative joint ventures may export products on their own or sell products through overseas sales agents or China's foreign-trade companies on a commission basis. Cooperative joint ventures may take out loans from financial institutions inside or outside China. However, the parties should each arrange any loans and their guarantee used as investments or cooperative means.

Application procedure

To apply for the establishment of a cooperative joint venture, the Chinese party must submit the following documents to the examination-and-approval organ:

- 1 a written proposal for the establishment of a cooperative project together with the written consent of the department-in-charge;¹⁹
- 2 a feasibility study report jointly prepared by the parties together with the written consent of the department-in-charge;
- 3 the joint venture agreement, joint venture contract, and articles of association signed by the legal representatives of the parties or the agents authorized by the legal representatives (the parties may agree to omit the joint venture agreement);
- 4 the business licenses or certificates of registration and certificates of creditworthiness of the parties, and valid proof of their legal representatives (where the foreign party is a natural person, valid proof of his or her identity, resume, and certificate of creditworthiness shall be provided);
- 5 a list of the chairperson, vice-chairperson and members of the board of directors, or a list of the head, deputy head and members of the joint management committee; and
- 6 any other documents required by the examination-and-approval organ.

The items to be included in the joint venture contract and articles of association of a cooperative joint venture are similar to those to be included in the joint venture contract and articles of association of an equity joint venture. However, since a cooperative joint venture may have a joint management committee rather than a board of directors and the parties to a cooperative joint venture may receive products rather than profits, provisions on corporate governance and profit distribution in the joint venture contract and articles of association of an equity joint venture should be included *mutatis mutandis* in the case of a cooperative joint venture. In addition, the joint venture contract of a cooperative joint venture should also include arrangements for the revenue and expenditure of foreign exchange and the procedure for amending the joint venture contract, while its articles of association should also include provisions on labor management, such as hiring, training, labor contract, wages, social insurance, welfare benefits, and occupational

safety. In any event, the formation, validity, interpretation, and performance of the joint venture contract and the resolution of any disputes over it are to be governed by Chinese law.

The examination-and-approval organ is either the MOFTEC (now the MOC) or a department or local government authorized by the State Council. Under the following circumstances, a department or local people's government authorized by the State Council shall conduct examination and approval of an application:

- 1 the total amount of investment is within the investment amount to be approved by the department or local people's government;
- 2 the parties have raised capital on their own, and the state does not need to balance construction and production conditions;
- 3 the exportation of the joint venture's products does not require export quota and license to be issued by the relevant department(s)-in-charge, or if export quota and license are required, the consent of the relevant department(s)-in-charge has been obtained prior to the submission of the application; and
- 4 other circumstances as prescribed by laws and administrative regulations in which the department or local people's government authorized by the State Council shall examine and approve cooperative joint ventures.

The examination-and-approval organ must approve or reject the application within 45 days of the receipt of all the required documents.

For a cooperative joint venture approved by the MOC or a department authorized by the State Council, the former shall issue the certificate of approval. For a cooperative joint venture approved by a local people's government, the certificate of approval shall be issued by the local people's government and be reported to the MOC for the record. Within 30 days of the receipt of the certificate of approval, the cooperative joint venture should apply for registration with the relevant AIC and obtain a business license. The date of the issue of the business license is the founding date of the cooperative joint venture. Within 30 days of its establishment, the cooperative joint venture must also go through the registration formalities with the tax authority.

During the term of the cooperative joint venture, if the parties make major revisions to the joint venture contract, they must obtain approval from the examination-and-approval organ. If such revisions concern registration items, including change of name, change of domicile, transfer of equity, change of director or general manager, increase or reduction of the registered capital, and establishment of a branch, the cooperative joint venture must go through the formalities of change of registration with the AIC.

Corporate governance

A cooperative joint venture must establish a board of directors or a joint management committee, which is its organ of power, to decide on important issues in accordance with the joint venture contract and the articles of association. Since

a legal-person cooperative joint venture is a limited liability company, it should establish a board of directors. A non-legal-person cooperative joint venture, however, shall establish a joint management committee. The board of directors or the joint management committee must have at least three members, and the allocation of the number of members is to be determined by the parties through consultation and with reference to their investments or cooperative means. The directors or committee members shall be appointed or replaced by the parties. If the chairperson of the board of directors or the head of the joint management committee is from one side, the vice-chairperson or deputy head must be from the other side. The chairperson of the board of directors or the head of the joint management committee is the legal representative of the cooperative joint venture. The term of office of a director or committee member shall be stipulated in the articles of association, but each term cannot exceed three years. Upon expiration of his or her term, the director or committee member may serve again if reappointed by the appointing party.

The board of directors or the joint management committee must meet at least once a year. A board or committee meeting may be convened if one-third or more of the directors or committee members propose. However, a board or committee meeting can be held only if two-thirds or more directors or members are present. If a director or committee member is unable to attend, he or she should authorize someone in writing to attend and cast the vote. A director or committee member who neither attends a meeting nor sends a proxy without any legitimate reason(s) shall be regarded as having attended the meeting and abstained from voting. The directors or committee members may also vote through communications.

The rules of procedure of the board of directors or the joint management committee shall be stipulated in the articles of association, unless otherwise provided in the implementation rules. Resolutions of the board of directors or the joint management committee shall be adopted by the affirmative votes of more than half of the attending directors or committee members. With respect to the following matters, a unanimous vote of all the attending directors or committee members is required:

- 1 the amendment of the articles of association;
- 2 the increase or reduction of the registered capital;
- 3 the dissolution of the joint venture;
- 4 the mortgage of the joint venture's assets;
- 5 the merger, division, or change of organizational form of the joint venture; and
- 6 any other matters agreed upon by the parties to be adopted only by a unanimous vote.

The board of directors or the joint management committee shall appoint a general manager to run the daily operations of the cooperative joint venture. The general manager is accountable to the board of directors or the joint management committee. Directors or committee members may concurrently serve as the general manager