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New Forms and Organizational Structures of Foreign Investment in China under the Company Law of the PRC

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Since the author has found misleading mistakes in some published English translations of the Company Law of the People's Republic of China, an English version of the law translated by the author is annexed to this article. The author would also like to thank Richard D. Morgan for his review of the author's translation of the Company Law. Any remaining errors should be attributed to the author.

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I. INTRODUCTION

The long-awaited Company Law of the People's Republic of China (Company Law)[1] is the first piece of national company legislation in China since the founding of the People's Republic of China (PRC) in 1949.[2] The Company Law signifies a landmark in Chinese commercial legislation and represents one of the boldest steps toward a market economy taken by the Chinese government since the reform and opening-up policy began in 1979.[3] Preceeded by a mass of both national and local interim regulations concerning forms and structures of limited

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1. *Zhonghua Renmin Gongheguo Gongsi Fa* [Company Law of the People's Republic of China], *reprinted in Renmin Ribao* [People's Daily], Dec. 31, 1994, at 2, 3, and 5. For an English translation of this law, see Appendix of this article [hereinafter Company Law].

2. *See* David Ho, *China's New Company Law: Something Concrete to Go By*, 16 E. ASIAN EXEC. REP. 9, 9 n.2 (1994).

3. By creating a legal framework for companies, the Company Law is meant to steer the Chinese planned economy to a market-oriented one. Qiao Shi, Chairman of the National People's Congress (NPC), China's top law-making body, pointed out after the adoption of the Law that "[t]he Law has an important significance in specifying the legal status of companies which are the main bodies of a market, in regulating a company's organizations and behavior, in establishing a modern enterprise system, and in enhancing the healthy development of a socialist market economy." *BBC Summary of World Broadcasts: Qiao Shi Addresses NPC Session, Stresses Need for a Proper Legal Framework* (BBC radio broadcast, Jan. 5, 1994) pt. 3, *available in* LEXIS, News Library, Bbcswb File. The policies underlying the creation of a new company legal regime were further enunciated by Chen Qingtai, Vice-Minister of the State Economic and Trade Commission of China:

> 1. It [the Company Law] is conducive to standardizing the market's behavior in the organization of its principal part, to invigorating enterprises, to deepening reform of enterprises, to establishing a modern enterprise system and to enabling a good market order to take shape.
>
> 2. It is conducive to accelerating the pace of transforming enterprises' operating mechanisms, to defining property rights involved in relationships clearly and improving the legal person system of enterprises, to protecting the accumulation and circulation of funds, to protecting the legitimate rights and interests of companies, shareholders, and creditors, and to promoting scientific and democratic decision-making through a legal system by enterprises in operation and management, thereby enabling them truly to become legal person entities.
>
> 3. It is conducive to accelerating the nurture and improvement of a market system, standardizing transactions on the market and maintaining the order of fair competition, thereby giving play to the basic role of the market mechanism in the distribution of resources.
>
> 4. It is helpful for the government to change functions, exercise administration according to law, separate truly its functions from those of enterprises and thereby employ legal means to conduct macroeconomic regulation and control in a better way to promote sustained, rapid and healthy national economic development as well as sweeping social progress.

BBC Summary of World Broadcasts: State Economic and Trade Commission Vice-Minister on Company Law, (BBC radio broadcast, Jan. 18, 1994), *available in* LEXIS, News Library, Bbcswb File.

No language concerning the Company Law's implications for foreign investment was specifically elaborated in the aforesaid policy statements, which was usually the case previously when a new law was passed. From the author's standpoint, this may be an indication that the Chinese government tends to incorporate foreign investment into the overall national economic system, and to regard the foreign investment sector as an integral part in the Chinese corporate picture.

liability companies and companies limited by shares,[4] the Company Law codifies the patchwork of existing regulations and provides a clear and uniform black letter law eliminating the confusion which resulted from the incoherent interim provisions.

The Company Law is the longest Chinese commercial legislation in China. It includes eleven chapters and 230 articles. The Company Law deals primarily with two corporate forms, limited liability companies and companies limited by shares; but one chapter deals solely with the branches of foreign companies.[5] In substance, the Company Law provides a wide spectrum of rules covering the conditions and procedures of forming limited liability companies and companies limited by shares, the organizational structures of companies, the issuance and transfer of shares of companies limited by shares, company bonds, financial and accounting requirements, mergers and divisions, bankruptcy, dissolution and liquidation, and the legal liabilities for Company Law violations. Of special interest to transnational practitioners, the Company Law also clearly defines the legal status and the permissible business scope of branches of foreign companies.

Since the first Chinese legislation regarding foreign direct investment was promulgated in 1979,[6] China has striven to create a full-fledged system of laws and administrative regulations on foreign commerce and investment in China.[7]

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4. The regulations include: *Gufen Youxian Gongsi Guifang Yijian* [Standard Opinions on Companies Limited by Shares], *reprinted in* TREATIES AND LAW DEPARTMENT OF THE MINISTRY OF FINANCE AND THE LEGAL REGULATIONS BUREAU OF THE STATE COUNCIL, SHIYONG ZHENGQUAN FAGUI HUIBIAN [COMPILATION OF PRACTICAL REGULATIONS ON SECURITIES] 206 (Economic Administration Publishing House 1992); *YouXian Zeren Gongsi Guifang Yijian* [Standard Opinions on Limited Liability Companies], *reprinted in* COMPILATION OF PRACTICAL REGULATIONS ON SECURITIES, at 234; *Shanghaishi Gufen Youxian Gongsi Zanxing Guiding* [Shanghai Municipality Interim Regulations on Companies Limited by Shares], *reprinted in* COMPILATION OF PRACTICAL REGULATIONS ON SECURITIES, at 419; *Shenzhenshi Gufen Youxian Gongsi Zanxing Guiding* [Shenzen Municipality Interim Regulations on Companies Limited by Shares], *reprinted in*COMPILATION OF PRACTICAL REGULATIONS ON SECURITIES, at 477.

5. It is reported that regulations concerning other types of companies such as holding companies and domestic, non-state-owned companies with a single shareholder are being drafted by the State Council. *See* Teresa Ko, *First National Legislation: Big Step Forward*, S. CHINA MORNING POST, Mar. 3, 1994 (Business), at 2.

6. *Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye fa* [Chinese-Foreign Equity Joint Venture Law of the PRC], *reprinted in* 1 CHINA'S FOREIGN ECONOMIC LEGISLATION 1 (Foreign Language Press 1984) [hereinafter EJV Law].

7. The principal laws and administrative regulations impacting foreign commerce and investment in China include:

a. Foreign Direct Investment: (1) CHINESE-FOREIGN EQUITY JOINT VENTURE LAW (July 1, 1979, *revised* Apr. 4, 1990); (2) REGULATIONS FOR IMPLEMENTATION OF THE CHINA-FOREIGN EQUITY JOINT VENTURE LAW (Sept. 20, 1983, *revised* Jan. 15, 1986 and Dec. 21, 1987); (3) STATE COUNCIL REGULATIONS ON THE ENCOURAGEMENT OF FOREIGN INVESTMENT (Oct. 11, 1986); (4) CHINA-FOREIGN CO-OPERATIVE ENTERPRISES LAW (Apr. 13, 1988); (5) WHOLLY FOREIGN OWNED ENTERPRISES LAW (Apr. 12, 1986); (6) DETAILED PROVISIONS FOR IMPLEMENTATION OF THE WHOLLY FOREIGN-OWNED ENTERPRISES LAW (Dec. 12, 1990); (7) REGULATIONS ON THE EXPLOITATION OF OFFSHORE PETROLEUM RESOURCES IN CO-OPERATION WITH FOREIGN ENTERPRISES (June 30, 1982).

b. Contracts with Foreign Elements: (1) FOREIGN ECONOMIC CONTRACT LAW (Mar. 21, 1985); (2) ADMINISTRATIVE RULES ON THE IMPORTATION OF TECHNOLOGIES (May 24, 1985); (3) DETAILED PROVISIONS FOR IMPLEMENTATION OF THE ADMINISTRATIVE RULES ON THE IMPORTATION OF TECHNOLOGIES

Though these laws and regulations have been functioning to create a legal regime for attracting foreign investment, people were still compelled to operate in a predominantly planned economy which lacked a national company code. It became apparent that China still needed to construct a more solid legal basis and to create a market-oriented economy conducive to the fast growth of foreign investment.

The momentum of nurturing a rational market economy culminated in a landmark, and perhaps irreversible amendment to the Constitution of the People's Republic of China by the National People's Congress (NPC) in March 1993. This amendment drastically changes "the State shall implement a *planned economy* on the basis of *socialist public ownership system*,"[8] a sacred motto in China for more than four decades, to "the State shall implement a *socialist market economy*. The State shall strengthen economic legislation to improve macro regulation and control."[9] This amendment paved an indispensable path for the legislation of the Company Law. The Company Law will fill some of the legislative vacancies in the area of commerce, and gear the process of privatization of Chinese state-

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(June 20, 1988).

c. Technology Transfer: INTERIM REGULATIONS ON TECHNOLOGY TRANSFER OF THE STATE COUNCIL (June 10, 1985).

d. Protection of Intellectual Property: (1) TRADEMARK LAW (Aug. 23, 1982); (2) DETAILED RULES FOR IMPLEMENTATION OF THE TRADEMARK LAW (Mar. 10, 1983, revised Jan. 13, 1988); (3) PATENT LAW (Mar. 12, 1984, revised Sept. 4, 1992); (4) DETAILED RULES FOR IMPLEMENTATION OF PATENT LAW (Jan. 19, 1985, *revised* Dec. 21, 1992); (5) COPYRIGHT LAW (Sept. 7, 1990); (6) DETAILED RULES FOR IMPLEMENTATION OF COPYRIGHT LAW (Mar. 30, 1991).

e. Foreign Trade: (1) FOREIGN TRADE LAW (May 12, 1994); (2) TARIFF REGULATIONS ON IMPORTS AND EXPORTS (Mar. 7, 1985, *revised* Sept. 12, 1987); (3) REGULATIONS ON THE INSPECTION OF IMPORT AND EXPORT COMMODITIES (Jan. 28, 1984).

f. Taxation on Foreign Investment: (1) INCOME TAX LAW CONCERNING FOREIGN ENTERPRISES (Dec. 13, 1981, *revised* Sept. 2, 1983); (2) DETAILED RULES FOR IMPLEMENTATION OF THE INCOME TAX LAW CONCERNING FOREIGN ENTERPRISES (Feb. 21, 1982).

For an introductory overview of Chinese economic laws relating to foreign trade, finance and investment, see RUI MU AND WANG GUIGUO, CHINESE FOREIGN ECONOMIC LAW: ANALYSIS AND COMMENTARY (International Law Institute 1990). For an insightful analysis of Chinese laws for foreign investment before 1988, see GUIGUO WANG, CHINA'S INVESTMENT LAWS: NEW DIRECTIONS (Butterworth 1988).

8. *Zhonghua Renmin Gongheguo Xianfa* [Constitution of the PRC], art.15, *reprinted in* THE LAWS OF THE PEOPLE'S REPUBLIC OF CHINA (1979-1982) 1 (Foreign Language Press 1987) (emphasis added).

9. *Zhonghua Renmin Gongheguo Xianfa Xiuzheng An* [Amendment to the Constitution of the PRC], art. 7, *reprinted in 1993 Nian Quanguo Lushi Zhige Kaoshi Fuxi Fagui Huibian* [COMPILATION OF LAWS AND REGULATIONS FOR NATIONAL BAR EXAMINATION OF 1993] n.20 (Ministry of Justice of China ed., Economic Administration Publishing House 1993) (emphasis added). A much more pragmatic and less ideological policy underpins this Amendment. Its significance is at least two-pronged. First, it provides a constitutional recognition of Chinese reform and opening-up during the past fourteen years. In addition, by writing the notion of socialist market economy into the Constitution to replace that of a planned economy as the cornerstone of socialism, it lays down a constitutional justification for future growth in private sectors including foreign investment, and for the fledgling legislation protecting the private economy. Since this is contrary to the traditional socialist principles in China, a question may be raised as to the reliability of this Amendment. Retrospectively viewed in the context of Chinese legislation and policies aimed at an efficient market economy since 1979, this Amendment is nothing but a natural summary of developments. In addition, Article 3 of this Amendment adds new language, "[t]he State shall stick to reforms and opening to the outside world," to the Preamble of the Constitution, thus further assuring the irreversible direction of market reform in China. For an official comment on this Amendment, see *China's Constitution to Be Amended*, 36 BEIJING REV. 4 (1993).

owned enterprises towards a legal track. To transnational practitioners, the Company Law presents new and rather complex implications for the forms and organizational structures of foreign direct investment in China. As will be discussed below, while the Chinese specialized laws in foreign investment enterprises, including joint ventures and wholly foreign-owned enterprises provide forms and structures for foreign investment enterprises, the Company Law, in general, aims at standardizing the forms and structures of Chinese companies as a whole. The goals and organizational structures of the specialized foreign investment laws and the Company Law are therefore different, and some of the general features of the Company Law may not be applicable to foreign investment enterprises, a specialized business sector in China. As a result, transnational practitioners will likely be concerned with the following issues: What does the Company Law mean to foreign direct investment in China? Is the Company Law complimentary to, consistent with, or even contradictory to, the existing Chinese laws on foreign direct investment? Will the structure of foreign direct investment in China be different under the Company Law, and if so, why and how?

This article explores some of the questions presented before transnational practitioners with regard to the Company Law. The core of this article investigates the implications of the Company Law as it relates to foreign direct investment. This article will introduce new forms and organizational structures of companies that may be used by foreign direct investors under the Company Law, including limited liability companies, companies limited by shares, and branches of foreign companies. Part II will briefly review the forms previously available to foreign direct investment in China before the Company Law was enacted.[10] Part III will concentrate on the conditions and processes of forming, and the operation of, limited liability companies and companies limited by shares.[11] Part IV will examine the organizational structures of these companies.[12] Part V will present a brief discussion comparing the advantages of the new forms under the Company Law.[13] Part VI concludes this article.[14] Where appropriate, this article will refer to prior Chinese laws and regulations governing foreign direct investment with the purpose of examining their differences with the Company Law and explicating the applicable rules.

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10. *See infra* notes 15-79 and accompanying text.
11. *See infra* notes 80-266 and accompanying text.
12. *See infra* notes 267-356 and accompanying text.
13. *See infra* notes 357-403 and accompanying text.
14. *See infra* note 404 and accompanying text.

II. VEHICLES AVAILABLE FOR FOREIGN DIRECT INVESTMENT (FDI) IN CHINA DURING THE PRE-COMPANY-LAW ERA

Under the legal system of China, legislation begins when the National People's Congress adopts a new economic law, composed of general rules and principles. The State Council, or in some cases, a ministry in charge of the area covered by the law, then promulgates detailed regulations for the implementation of those principles.[15] The Chinese-Foreign Equity Joint Venture Law of PRC (EJV Law),[16] for example, contains only fifteen articles, while the Regulations for Implementation of the Chinese-Foreign Equity Joint Venture Law (EJV Implementation), promulgated by the State Council, comprises 118 articles.[17] This system is often criticized by foreign lawyers because of a time lag of more than one year between the enactment of a law by the NPC and the promulgation of its implementing regulations by the State Council.[18] However, this system works well because the government receives feedback on the law, allowing it to reevaluate its economic reform and, through implementing regulations, readjust the law to meet policy considerations.[19] The legal framework for foreign direct investment has so far been evolving through this practice.

Prior to the enactment of the Company Law, the vehicles available for foreign investors included: (1) equity joint ventures (EJVs); (2) contractual, or co-operative joint ventures (CJVs); and (3) wholly foreign-owned enterprises (WFOEs). In practice, as provided in the Provisions of the State Council for Encouragement of Foreign Investment,[20] these three types of entities are collectively termed "enterprises with foreign investment" (EFIs).[21] The laws and regulations with respect to these foreign-funded ventures are usually referred to as "laws regarding foreign investment enterprises." Furthermore, the EJV, CJV, and WFOE laws provide that the term "foreign investors" refers to foreign companies, enterprises and other foreign economic organizations or individuals.[22]

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15. *See* L.J. Brahm, *China: Evolving Legal Reforms for Foreign Investment*, EUROMONEY SUPP., June 14, 1992.

16. EJV Law, *supra* note 6.

17. *Zhonghua Renmin Gongheguo ZhongWai Hezi Fingying Qiyefa Shishi Tiaoli* [Regulations for the Implementation of the Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures] art. 19, *reprinted in* 3 CHINA'S FOREIGN ECONOMIC LEGISLATION 1 (Foreign Language Press 1984) [hereinafter EJV Implementation].

18. Brahm, *supra* note 15.

19. *Id.*

20. *Guowuyuan Guangyi Guli Waishang Touzi de Guiding* [Provisions of the State Council for Encouragement of Foreign Investment], *reprinted in* 4 CHINA'S FOREIGN ECONOMIC LEGISLATION 248 (Foreign Language Press 1984).

21. *Id.* art. 2.

22. EJV Law, *supra* note 6, art. 1. Article 1 provides:

> In order to expand international economic co-operation and technological exchange, the People's Republic of China permits foreign companies, enterprises, other economic organizations or individuals [hereinafter referred to as "foreign investors"] to join with Chinese companies, enterprises or other economic organizations [hereinafter referred to as "Chinese investors"] in establishing equity joint ventures in the PRC according to

A. Chinese-Foreign Equity Joint Venture (EJV)

The first piece of Chinese legislation relating to foreign direct investment is the EJV Law, which establishes the equity joint venture as the basis for foreign direct investment in China.[23] In 1983, the State Council promulgated the EJV Implementation, which provides detailed rules regarding the procedures for establishing EJVs, contribution of capital, technology transfer, and the functions of the board of directors.[24] The EJV Law was amended by the NPC in April 1990, and the EJV Implementation was revised by the State Council in 1986 and 1987 in order to create a more favorable legal regime for foreign investors.[25]

An EJV is specified to take the form of a limited liability company.[26] The foreign party must contribute at least twenty-five percent of the registered capital of an EJV.[27] The registered capital of an EJV must, in general, be expressed in Renminbi[28] or in a foreign currency agreed to by the parties to an EJV.[29] During the term of its operation, an EJV is not allowed to reduce its registered capital.[30] The parties to the venture share profits, risks, and losses in proportion to their respective contributions to the registered capital.[31] The transfer of the registered capital by a party to the venture is subject to the consent of the other parties and approval by the examination and approval authority.[32]

The procedure for establishing an EJV is quite well-developed. The authority in charge of examining and approving an EJV is the Ministry of Foreign Trade and Economic Co-operation (MOFTEC).[33] In order to efficiently process applications and reduce the caseload of MOFTEC, under certain circumstances, MOFTEC may authorize the government of the People's Republic of China at the

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the principle of equality and mutual benefit and subject to approval of the Chinese Government.

Id. See also Zhonghua Renmin Gongheguo Waizi Qiye Fa [Wholly Foreign Owned Enterprise Law] art. 1, *reprinted in* 4 CHINA'S FOREIGN ECONOMIC LEGISLATION 234 (Foreign Language Press 1984) [hereinafter WFOE Law]; *Zhonghua Renmin Gongheguo Zhongwai Hezuo Jingying Qiye Fa* [Chinese-Foreign Co-operative Joint Venture Law] art. 1, *reprinted in* COMPILATION OF LAWS AND REGULATIONS FOR NATIONAL BAR EXAMINATION OF 1993, at 368 (Ministry of Justice ed., Economic Administration Publishing House 1993) [hereinafter CJV Law].

23. EJV Law, *supra* note 6.

24. EJV Implementation, *supra* note 17.

25. For a review of these legislative amendments, see MU & GUIGUO, *supra* note 7.

26. EJV Law, *supra* note 6, art. 3; EJV Implementation, *supra* note 17, art. 19.

27. EJV Law, *supra* note 6, art. 4.

28. Renminbi (RMB) is the Chinese official currency. The market exchange rate in China for Renminbi on July 5, 1994 is US$100 = RMB 865 yuan. *See* CHINA DAILY, July 6, 1994, at 2, col. 7.

29. EJV Implementation, *supra* note 17, art. 21.

30. *Id.* art. 22.

31. EJV Law, *supra* note 6, art. 4; EJV Implementation, *supra* note 17, art. 23.

32. *Id.*

33. EJV Implementation, *supra* note 17, art. 8.

provincial level, or a relevant department of the State Council, to conduct examination and approval.[34]

To form an EJV, the Chinese party to the proposed EJV must first submit to the proper department the necessary documents, including a project proposal and a preliminary feasibility study report with respect to the proposed EJV.[35] Such department will then transmit these documents to the examination and approval authority, usually the MOFTEC.[36] Only after the examination and approval authority has approved the preliminary feasibility study report may the parties to the EJV undertake a final feasibility study and negotiate and execute the EJV agreement and articles of association.[37] Afterwards, the parties must submit to the examination and approval authority, an application for establishment, which includes a feasibility study report jointly prepared by the parties, the EJV agreement and articles of association, a list of candidates for the chairman, vice chairmaen, and other members of the board of directors, and the official opinions from the department in charge of the Chinese party and the government of the People's Republic of China at the provincial level where the EJV is to be located.[38] The examination and approval authority must make its decision on an application within three months after the receipt of all of these documents.[39] The EJV Law and the EJV Implementation do not provide any regulation on the appeal procedure if an application is denied.

Within one month after receipt of the approval certificate, the applicants are required to carry out the procedures of registration at the administrative bureau of industry and commerce at the provincial level where the EJV is to be located.[40] The EJV is formally established upon the issuance of a business license from the registration authority.[41] The parties to an EJV may contribute their respective investments in cash or in kind, including currency, building, plant, machinery and equipment or other materials, industrial property rights, know-how, and land use rights.[42]

The law only provides some general provisions concerning the internal organizational structure of an EJV, with one single article in the EJV Law and ten articles in the EJV Implementation. The board of directors is specified as the

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34. *Id.* There are two conditions regulated by this Article under which MOFTEC shall authorize its power to other departments or provincial governments: (1) the total amount of investment is within the limit prescribed by the State Council, and the source of funds for the Chinese party has already been fixed; and (2) the EJV will not require any additional allocation of raw and processed materials by the State, nor will it affect the national balance of fuel and power supplies, communication and transportation, or foreign trade export quotas. *Id.*

35. *Id.* art. 9.

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.* art. 10.

40. *Id.* art. 11.

41. *Id.*

42. *Id.* art. 25.

highest organ of authority of an EJV.[43] The board of directors must consist of at least three members.[44] The apportionment of the members is to be determined through consultation between the parties to the EJV, taking into account the ratio of their respective investments in the EJV.[45] The directors must be appointed by the parties of the EJV.[46] In the 1979 EJV Law, it was provided that the chairman of the board must be appointed by the Chinese party, and the vice chairman by the foreign party.[47] This limitation discouraged foreign investment because foreign investors, regardless of the scale of their investment, might not retain majority control over the EJV's operation.[48] To eliminate this problem, the NPC amended the EJV Law in 1990, providing that either Chinese or foreign parties may be appointed as the chairman, thus offering equal opportunity for control of the board to various parties to the EJV.[49]

Another significant aspect of the EJV law is the statutory limit for the duration of an EJV. In the EJV Implementation of 1983, the period of an EJV agreement was generally limited to thirty years.[50] In 1986, this was amended to allow the period of an EJV to be extended for more than fifty years depending on such

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43. *Id.* art. 33.
44. *Id.* art. 34.
45. *Id.*
46. *Id.*
47. EJV Law, *supra* note 6, art. 6.
48. Li Ping, *Amended Joint Venture Law: A Major Step to Improve Investment Climate*, 33 BEIJING REV. 24 (1990). The official Beijing Review commented that:

> According to the article (Article 6 of EJV Law), no matter how much money the overseas partners invested in a joint venture, they could not assume the post of chairman of the board of directors. Over the past ten years, many foreign partners have suggested amending the article because it is not in keeping with international practice. Their Chinese partners also felt that the article was not conducive to encouraging foreign businessmen to invest more in China.

Id.

49. EJV Law, *supra* note 6, art. 6. The amendment reads:

> The chairman and vice chairman of the board of directors shall be determined through consultation by all parties to the EJV or be elected by the board of directors. Where one party between a Chinese party and a foreign party is appointed as chairman, the other party shall be appointed vice chairman.

Id. It should be noted that, according to this rule, the positions of chairman and vice chairman must be split between the Chinese and foreign parties. *Id.* In other words, these positions cannot be both held only by the Chinese party or only by the foreign party. *Id.*

50. Regulations for Implementation of the China Foreign Equity Joint Venture Law (Sept. 20, 1983) *reprinted in* 3 CHINA FOREIGN ECONOMIC LEGISLATION 1 (Foreign Language Press 1984) [hereinafter 1983 EJV Implementation]. Article 100 of the 1983 EJV Implementation provides:

> The term of a joint venture shall be decided through consultation between the parties to the venture on the basis of the specific conditions of the particular line of business and the project involved. In principle, the term of a joint venture involving an ordinary project shall be from 10 to 30 years. If a joint venture project involves a large investment, a long construction period and a low profit rate, the term of the joint venture may exceed 30 years.

Id.

situations as the amount of investment, construction period, profit rate, and the level of advanced technology provided by a foreign investor.[51]

B. Chinese-Foreign Contractual Joint Venture (CJV)[52]

For years following the adoption of the EJV Law, many CJVs were formed with the structure of a partnership. In the absence of any specific law, these enterprises loosely followed the concepts laid out in the EJV Law. To address the question of this gap in the legislation, the NPC adopted the CJV Law on April 13, 1988.[53]

Most provisions such as formation, capital contribution methods, and transfer of technology, in the CJV Law are similar to those in the EJV Law. A CJV, however, is a more flexible vehicle for direct foreign investment. A CJV may be a separate legal entity or just a loosely-linked contractual arrangement between Chinese and foreign parties to cooperate in a project or other business, such as Chinese-foreign joint exploration of natural resources and build-operate-transfer (BOT) projects.[54] CJV investors may enjoy limited liability if the CJV qualifies as a legal person under Chinese law.[55] There is no minimum percentage of capital contribution required for foreign investors. CJV investors have the freedom to negotiate among themselves an allocation of profits not in proportion to their respective capital contributions.[56] The relative timing of distributions among the venturers is also negotiable.[57] In addition, a CJV may either establish a board of directors or a "combined management body" to decide major issues of the contractual enterprises.[58] Thus, investors in short-term cooperative projects who want flexibility in tailoring joint ventures, and investors who want to do business

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51. Regulations for Implementation of the China Foreign Equity Joint Venture Law (Dec. 21, 1987) *reprinted in* 3 CHINA FOREIGN ECONOMIC LEGISLATION 1 (Foreign Language Press 1984) [hereinafter 1987 EJV Implementation]. Article 100 of the 1987 EJV Implementation provides:

> The term of a joint venture shall be decided through consultation between the parties to the venture on the basis of the specific conditions of the particular line of business and the project involved. The term of a joint venture involving an ordinary project shall be from 10 to 30 years. In the case of a joint venture project involving a large investment, a long construction period and a low profit rate, a project in which advanced technology or key technology for the production of highly sophisticated products is provided by the foreign joint ventures, or a project in which the products are internationally competitive, its joint venture term may be extended to 50 years. Upon special approval by the State Council, the term may be more than 50 years.

Id.

52. Author's note: In Chinese, a Chinese-foreign contractual joint venture is called *zhongwai hezi jingying qiye*, which literally means "Chinese-foreign cooperative management enterprise."

53. *See* Brahm, *supra* note 15.

54. CJV Law, *supra* note 22, art. 2. Article 2 stipulates that "a contractual enterprise shall, if meeting the conditions of a legal person provided by Chinese law, obtain the status of a Chinese legal person in accordance with the law." *Id.* This means that a CJV may or may not be a legal person.

55. *Id.*

56. *Id.*

57. *Id.*

58. *Id.* art. 12.

with Chinese partners on a trial basis in China may prefer the CJV format over the EJV format.

C. Wholly Foreign-Owned Enterprise (WFOE)

The Chinese government has made significant progress in attracting foreign investment in the area of WFOEs. In April 1986, the NPC adopted the WFOE Law, which permits foreign investors to hold a 100 percent ownership in their private enterprises. This law, along with the Detailed Provisions for Implementation of the Wholly Foreign-Owned Enterprises Law (WFOE Implementation),[59] which was promulgated by the State Council in 1990, has made the Chinese legal system far more liberal in this area than many other jurisdictions in Asia. While local participation is required in countries such as Malaysia and Thailand, China permits foreign investors to wholly own the enterprises, provided that such entities are engaged in activities which involve either technology transfer or export production.[60]

WFOEs are usually limited liability companies, under which a foreign investor is liable to the WFOE to the extent of the investors' capital contribution.[61] There is no minimum registered capital requirement for a WFOE, but the registered capital of a WFOE must be sufficient in light of the size of its operations.[62] A WFOE is not allowed to reduce the registered capital during its period of operation.[63] Any increase or transfer of registered capital in a WFOE is subject to approval by the examination and approval authority, and a procedure of amendment registration to this increase or transfer should be carried out with an administrative bureau of industry and commerce.[64] From the author's point of view, this administrative requirement on the increase or transfer of registered capital in a WFOE reflects a policy consideration of the Chinese government to monitor and manage the foreign capital direction of foreign investment.

The capital contribution for a WFOE can be made in cash or in kind, including foreign convertible currency, machinery, equipment, industrial property, and know-how.[65] Subject to approval by the examination and approval authority, a foreign investor may make its capital contribution by using its RMB profits

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59. *Zhonghua Renmin Gongheguo Waizi Qiyefa Shishi Xizhe* [Detailed Provisions for Implementation of the Wholly Foreign-Owned Enterprise Law of the PRC] art. 19, *reprinted in* CHINA LAWS FOR FOREIGN BUSINESS (CCH Australia Ltd 1991), para.13-507, at 16, 658 [hereinafter WFOE Implementation].

60. *See* Brahm, *supra* note 15. Article 3 of the WFOE Law provides that "[f]oreign enterprises shall be established in such a manner as to help the development of China's national economy; they shall use advanced technology and equipment, or market all or most of their products outside China." WFOE Law, *supra* note 22, art. 3.

61. WFOE Implementation, *supra* note 59, art. 19.

62. *Id.* art. 21.

63. *Id.* art. 22.

64. *Id.* art. 23.

65. *Id.* art. 26.

earned from other foreign invested enterprises established within the territory of China.[66] If a foreign investor capitalizes industrial property rights or know-how to make its capital contribution, the price may not exceed twenty percent of the registered capital of the WFOE.[67]

The application procedure for approval and registration of a WFOE is similar to that of an EJV.[68] The MOFTEC has full authority to grant permission for a WFOE, but in some cases the State Council may authorize the government of the People's Republic of China at the provincial level or the government of the People's Republic of China of a special economic zone (SEZ) to grant the approval.[69]

Unlike EJVs, there is no mandatory limitation on the period for the operation of a WFOE. The WFOE Implementation provides that the period of operation may be determined by the foreign investor in the application for establishment of a WFOE in accordance with the specific situations of different industries and enterprises, and must be approved by the examination and approval authority.[70]

A WFOE is specified as a Chinese legal person;[71] therefore contracts completed between a WFOE and another Chinese entity are governed by the Economic Contract Law of the PRC,[72] which is applicable to all Chinese domestic businesses, rather than being governed by the Foreign Economic Contract Law of the PRC,[73] which governs all contracts completed between a Chinese party and a foreign party.[74] Thus, when a WFOE signs a contract with a foreign company, the Foreign Economic Contract Law will apply.

In principle, the WFOE is required to export most of its products, and is only allowed to sell its products in the Chinese market in accordance with the sale proportion permitted by the government.[75] For a WFOE to exceed the approved sale proportion, it must obtain permission from the examination and approval authority.[76] The price of the products sold on the Chinese market should not violate the Chinese regulations with respect to price control.[77] For a foreign investor in the WFOE, the export requirement still constitutes a legal hurdle to

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66. *Id.*
67. *Id.* art. 28.
68. *Id.* arts. 8-18 (dealing with the issue of formation procedure of a WFOE).
69. *Id.* art. 8. The two conditions under which the State Council shall authorize the power of approval to the local government provided in this article include: (1) the total amount of investment is within the limit of investment approving authority prescribed by the State Council; (2) [the WFOE] will not require any additional allocation of raw and processed materials by the State, nor will it affect the national comprehensive balance of fuel and power supplies, communication and transportation, or foreign trade export quotas. *Id.*
70. *Id.* art. 73.
71. WFOE Law, *supra* note 22, art. 8.
72. *Zhonghua Renmin Gongheguo Jingji Hetong Fa* [Economic Contract Law of the PRC], *reprinted in* CHINA LAWS FOR FOREIGN BUSINESS (CCH Australia Ltd 1991), para. 5-500, at 6,254.
73. *Zhonghua Renmin Gongheguo Shewai Jingji Hetong Fa* [Foreign Economic Contract Law of PRC], *reprinted in* CHINA LAW FOR FOREIGN BUSINESS (CCH Australia Ltd 1991), para. 5-550, at 6,621.
74. *Id.* art. 2.
75. WFOE Implementation, *supra* note 59, art. 45.
76. *Id.*
77. *Id.* art. 48.

penetrate and gain full access to the vast Chinese domestic market. Therefore, a foreign investor should establish a WFOE in an industry which is underdeveloped in China and whose products may be sold in China without many restrictions. The general guideline for products marketable in China by the WFOE is that these products should be urgently needed by China and can be substituted for imports.[78] Subject to approval by a Chinese foreign exchange control authority, these products may be paid for in foreign exchange.[79]

III. NEW FORMS FOR FDI UNDER THE COMPANY LAW

According to Article 18, the Company Law also applies to limited liability companies engaged in foreign investment.[80] Article 75 allows foreign investors to participate in the formation of companies limited by shares by specifying that, to form companies limited by shares, there must be five or more promoters, of which more than one-half must have their domiciles within the territory of China.[81] Therefore, the Company Law, though primarily aimed at reorganizing Chinese state-owned enterprises into companies, opens new options of great significance to foreign direct investment in China.

The Company Law defines "companies" to mean limited liability companies and companies limited by shares.[82] Limited liability companies and companies limited by shares share some common features under the Company Law. Both are Chinese legal persons whose financial liabilities are limited to the extent of their assets.[83] For a limited liability company, a shareholder is liable to the company to the extent of the amount of his capital contribution, and for a company limited by shares, its capital is divided into shares of equal value and a shareholder is liable to the company to the extent of the shares held.[84] As a capital contributor, a shareholder in a company, in proportion to the amount of capital invested in the company, is entitled to enjoy the rights of ownership, such as benefiting from the company's assets, participating in major decision-making and choosing the managerial personnel.[85] However, as will be discussed below, the two types of companies are substantially different in various respects such as the conditions and methods of formation, and the process of establishment.

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78. *Id.* art. 58.
79. *Id.*
80. Company Law, *supra* note 1, art. 18.
81. *Id.* art. 75.
82. *Id.* art. 2.
83. *Id.* art. 3.
84. *Id.*
85. *Id.* art. 4.

A. Limited Liability Companies

Article 18 of the Company Law provides that the Company Law is to apply to foreign invested-limited liability companies,[86] but that the laws regarding foreign investment enterprises will prevail over the Company Law if the former provides otherwise.[87] The legal implication of this provision is threefold. First, foreign investors may establish new operations by following only the specialized foreign investment laws regarding EJVs, CJVs, and WFOEs. Second, the preexisting foreign investment enterprises may maintain their status quo. Third, foreign investors may start outright to establish limited liability companies by following the Company Law. Furthermore, pre-existing foreign investment enterprises may be reorganized as limited liability companies in compliance with the requirements under the Company Law. Where the Company Law is silent, the specialized laws regarding foreign investment enterprises will be the gap-fillers; where there is a conflict between the Company Law and the laws regarding foreign investment enterprises the provisions regarding foreign investment enterprises will be controlling. Therefore, a foreign investment enterprise, such as a WFOE or EJV, organized according to the Company Law as a limited liability company, shall be subject to two sets of laws: the Company Law, and the laws regarding foreign investment enterprises, the WFOE Law and EJV Law respectively.[88] For this reason, the following discussion on limited liability companies will include the relevant provisions of laws regarding foreign investment enterprises which will prevail over the Company Law or function as gap-fillers.

1. Conditions for the Formation of Limited Liability Companies

The Company Law sets out the conditions that must be fulfilled before a limited liability company can be formed.[89] A limited liability company must be formed by at least two, but not more than fifty, shareholders who jointly

86. Throughout the text, the terms "foreign-invested limited liability companies" and "limited liability companies with foreign investment" will be used interchangeably.

87. Company Law, *supra* note 1, art. 18.

88. The goal of the Company Law is to regulate and standardize business forms within China, principally Chinese domestically-funded companies. Some provisions may only be desired by the legislature for Chinese domestically-funded companies. It seems reasonable to the author that a limited liability company with foreign investment should follow the provisions in the specialized laws regarding foreign investment enterprises where there is a conflict with, or a silence in, the Company Law. Through this mechanism, the Chinese government may be able to assure that the specific goals in specialized laws regarding foreign investment enterprises are carried out.

89. Company Law, *supra* note 1, art. 19. Article 19 sets forth the following conditions: (1) the number of shareholders must satisfy the statutory requirement, i.e. from two to fifty shareholders; (2) the capital contribution of shareholders must reach the statutory threshold for incorporation; (3) the shareholders must jointly formulate the company's articles of association; (4) the company must have a company name, and must have established an organizational structure in conformity with the requirement for a limited liability company; and (5) the company must have a fixed site for production and operation, and meet other conditions necessary for production and operation. *Id.*

contribute their capital.[90] The Company Law does not impose any limitation on foreign ownership in a limited liability company. However, it does not specify how many foreign investors may be allowed as incorporators of a limited liability company, in contrast to a company limited by shares, as will be discussed below, where foreign promoters of the company limited by shares may not exceed half of the promoters.[91] One interpretation for this is that the foreign ownership proportion in a limited liability company established jointly with Chinese incorporators is a matter to be negotiated among the foreign and Chinese incorporators, and the Company Law in fact allows foreign investors to establish a wholly-owned limited liability company. In the case of an EJV-type limited liability company, a limited liability company jointly established by foreign and Chinese investors, the foreign-capital-proportion requirement in the EJV Law must be followed. The EJV Law provides that the proportion of capital contribution by foreign investors in an EJV must be more than twenty-five percent of the total registered capital of the EJV.[92] Therefore, in an EJV-type limited liability company, the foreign incorporators must, at a minimum, hold a twenty-five percent stake.

As to the articles of association of a limited liability company, the Company Law requires that they contain items including the name and domicile of the company, the business scope of the company,[93] registered capital, names of shareholders, rights and obligations of shareholders, conditions for the transfer of capital by shareholders, internal organization of the company and its establishing procedures, functions and authorities, rules of procedure, designation of a legal representative of the company, and basis for company dissolution and liquidation procedures.[94]

As a general corporate law for all domestic companies, the Company Law does not have provisions regarding the permissible, restricted or prohibited industries for limited liability companies. Thus, it is necessary to refer to the laws governing EJVs and WFOEs. For an EJV-type limited liability company, Article 3 of the EJV Implementation will be applicable to this issue. Article 3 of the EJV Implementation provides that the permissible lines of business for EJVs are as follows:

> (1) energy resources development, and the construction materials, chemical and metallurgical industries;

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90. *Id.* art. 20.

91. *Id.* art. 75. *See also infra* notes 136-149 and accompanying text (discussing conditions for formation of companies limited by shares).

92. EJV Law, *supra* note 6, art. 4.

93. The kind of business an entity can conduct is still limited to what is stated in its business license approved by the company registration authority. Thus, every entity has its preapproved "business scope" (*jingying fanwei*).

94. Company Law, *supra* note 1, art. 22.

(2) the machine-building, instrument and meter industries, and offshore oil-mining equipment manufacturing;
(3) electronic industry, computer industry and communications equipment manufacturing;
(4) light industries, textile, food, pharmaceutical, medical apparatus and instruments and packaging industries;
(5) agriculture, animal husbandry and aquaculture; and
(6) tourism and service industry.[95]

For WFOE-type limited liability companies, the WFOE Implementation does not specifically provide the permissible lines of business as does the EJV Implementation. Rather, it specifies two general conditions for the establishment of a WFOE in China: (1) the WFOE must adopt advanced technology and equipment, engage in the development of new products, economize on the use of energy and raw materials, and achieve product upgrading and replacement or produce import substitutes; and (2) the WFOE must have annual exports amounting to at least fifty percent of the value of its total product output for the year and achieve a foreign exchange balance or surplus.[96] It should be noted that under the WFOE Implementation, WFOEs may not be established in certain industries.[97] In addition, there are five categories of industries in which WFOE establishment is restricted, or subject to limitations.[98] To establish a WFOE in one of these restricted industries, a foreign investor is required to submit an application with the MOFTEC for approval.[99]

2. *Registered Capital of Limited Liability Companies*

The registered capital of a limited liability company is the amount of capital actually contributed by all of the shareholders, and registered with the company registration authority.[100] The requirements of minimum registered capital of limited liability companies are based on the types of business sectors in which the company is involved.[101] The Company Law does not list such industries as

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95. EJV Implementation, *supra* note 17, art. 3.
96. WFOE Implementation, *supra* note 59, art. 3.
97. *Id.* art. 4. The prohibited industries are: (1) newspaper, publishing, broadcasting, television or movies; (2) domestic commerce, foreign trade or insurance; and (3) the post service and communication industries. *Id.*
98. *Id.* art. 5. The restricted industries include public utilities, transportation, real estate, trust investment, and leasing. *Id.*
99. *Id.*
100. Company Law, *supra* note 1, art. 23.
101. *Id.* art. 23. For a company engaging in production operations as its principal business, the requirement is RMB 500,000 yuan; for a company engaging in commodity wholesaling as its principal business, the requirement is RMB 500,000 yuan; for a company engaging in commercial retailing as its principal business, the requirement is RMB 300,000 yuan; for a company engaging in scientific and technological development, consultancy and service, RMB 100,000 yuan. *Id. See supra* note 28 (stating the exchange rate between the US dollar and the Chinese Renminbi).

insurance, banking, transportation and exploration of natural resources. Rather, the Company Law stipulates that for companies engaging in special businesses not specified in the Company Law, their minimum registered capital will be determined by other laws and regulations to be promulgated by the authorities.[102] It is expected that future implementation regulations of the Company Law will provide more specific rules.

In 1987, the State Administration for Industry and Commerce, the Chinese governmental institution in charge of company and enterprise registration, issued the Interim Provisions Concerning the Ratio Between the Registered Capital and Total Investment in Chinese-Foreign Joint Ventures (Ratio Provisions).[103] There are four kinds of statutory ratios between the registered capital and the total investment in a Chinese-foreign joint venture: (1) If a Chinese-foreign joint venture has a total investment of US$3,000,000 or less, its registered capital should account for at least seven-tenths of the total investment; (2) If a Chinese-foreign joint venture's total investment is between US$3,000,000 and US$10,000,0000, its registered capital should make up at least half the total investment, but if the total investment is below US$4,200,000, the registered capital should not be lower than US$2,100,000; (3) If a Chinese-foreign joint venture's total investment is between US$10,000,000 and US$30,000,000, its registered capital should account for at least two-fifths of the total investment, but if the total investment is below US$12,500,000, the registered capital should not be lower than US$5,000,000; and (4) If a Chinese-foreign joint venture's total investment exceeds US$30,000,000, its registered capital should constitute at least one third of the total investment, but if the total investment is below US$36,000,000, the registered capital should not be less than US$12,000,000.[104] The Ratio Provisions also stipulate that if a Chinese-foreign joint venture, under special circumstances, cannot meet the above-mentioned regulations, the venture must be approved jointly by the MOFTEC and the State Administration of Industry and Commerce.[105] It is important to note that the above mandatory ratios are also applicable to CJVs and WFOEs.[106]

3. *Capital Contribution*

The method of capital contribution to form a limited liability company under the Company Law is similar to what is provided under the EJV

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102. *Id.*

103. Interim Provisions of State Administration for Industry and Commerce concerning the Ratio Between the Registered Capital and Total Investment in Chinese-Foreign Joint Ventures *reprinted in* 4 CHINA'S FOREIGN ECONOMIC LEGISLATION 337 (Foreign Language Press 1984) [hereinafter Ratio Provisions].

104. *Id.* art. 3.

105. *Id.* art. 4.

106. *Id.*

Implementation.[107] Shareholders may either contribute in cash or in kind, including tangible or intangible property.[108] Where capital contributions are in the form of tangible property, industrial property rights, nonproprietary technology, or land use rights, these forms of contribution in kind must first be appraised and valued, and the results must subsequently be verified.[109] Further, the value of industrial property rights and non-proprietary technology contributed may not exceed twenty percent of the registered capital of a limited liability company, unless otherwise provided by the relevant laws and regulations regarding the use of high and new technological developments.[110] While there is also a twenty percent limitation for foreign investors under the WFOE implementation,[111] under the EJV Law and EJV Implementation there is no such limitation for foreign investors. Thus, if a foreign investor's capital contribution in kind needs to be more than twenty percent of the registered capital, it is advisable to establish an EJV rather than a limited liability company, so that there will be no limitation on the percentage of the in kind contribution.

The Company Law does not provide any criteria about what kinds of in kind contribution are permissible. The EJV Implementation and the WFOE Implementation, however, include some principles which will be applicable to a limited liability company with foreign investment.

The EJV and WFOE Implementations both contain limitations on capital contribution of machinery, equipment and other materials. Both the EJV Implementation and the WFOE Implementation impose three similar conditions in this regard. First, they must be indispensable to the production of the enterprise.[112] Second, they cannot be produced in China, or, although they can be produced in China, their price would be too high, or, with respect to technical performance and delivery time, there could be no assurance that the enterprises' requirements would be met.[113] Third, the fixed value assigned to them may not exceed the current international market price for the same type of machinery, equipment or other materials.[114]

The EJV and WFOE Implementations also contain limitations on capital contribution by industrial property rights or non-proprietary technology. However, the provisions for an EJV and a WFOE in this regard are not the same. For an EJV, the EJV Implementation specifies that such intangible property must meet one of three requirements: (1) the intangible property must be capable of producing new products urgently needed in China, or products suitable for export; (2) the intangible property can markedly improve the performance and quality of

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107. EJV Implementation, *supra* note 17, art. 25.
108. Company Law, *supra* note 1, art. 24.
109. *Id.*
110. *Id.*
111. WFOE Implementation *supra* note 59, art. 28.
112. EJV Implementation, *supra* note 17, art. 27; WFOE Implementation, *supra* note 59, art. 27.
113. *Id.*
114. *Id.*

existing products and raise productivity; or (3) such property can markedly conserve raw or processed materials, fuel or power.[115] Conversely, two conditions must be met for a WFOE: (1) title to the rights or technology must belong to the foreign investor itself, and (2) the right or technology is suitable for use in manufacturing new products urgently needed in China or products suitable for export.[116]

4. Registration for Establishment of Limited Liability Companies

After a shareholder has made its capital contribution in full, a capital verification certificate will be issued by a legal capital verification organization,[117] which is usually an office of a certified public accountant. Upon capital verification, a representative appointed by all shareholders, or an agent jointly authorized by all shareholders, must make an application to the company registration authority to register the limited liability company. The representative must submit documents, including a company registration application, the articles of association and a capital verification certificate.[118] If other laws and regulations require the establishment of a company to be subject to examination and approval by relevant authorities, documents of such approval must also be submitted.[119] Since the establishment of an EJV or a WFOE is subject to governmental examination and approval under the laws regarding foreign investment enterprises,[120] incorporators of limited liability companies with foreign investment will be required to submit such approval documents when applying for registration.

The issuing date of a business license by the company registration authority is regarded as the date of establishment of a limited liability company.[121] A limited liability company may at the same time of its formation set up a branch and apply for its registration.[122] The Company Law clarifies the legal status of a branch and a subsidiary by providing that a branch of a company will not have the status of a legal person, and the company must assume the branch's civil liability.[123] In contrast, a subsidiary of a company shall have legal person status and independently assume its civil liabilities in accordance with the applicable laws.[124]

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115. EJV Implementation, *supra* note 17, art. 28.
116. WFOE Implementation, *supra* note 59, art. 28.
117. Company Law, *supra* note 1, art. 26.
118. *Id.* art. 27.
119. *Id.*
120. *See supra* notes 23-51, 59-79 and accompanying text (discussing the establishment requirements for EJVs and WFOEs).
121. Company Law, *supra* note 1, art. 27.
122. *Id.* art. 29.
123. *Id.* art. 13.
124. *Id.*

After a limited liability company has been established, a capital contribution certificate affixed with the official seal of the company must be issued to each shareholder.[125] The capital contribution certificate must state the company's name, the registration date of the company, the registered capital, the shareholder's name, the amount and date of paid-in capital contribution, the serial number and issuing date of the capital contribution certificate.[126] A limited liability company is required to keep in its office a shareholders' register which records the names, domiciles and capital contribution of shareholders and the serial numbers of capital contribution certificates.[127]

5. *Transfer of Capital Contribution by Shareholders of Limited Liability Companies*

Shareholders are not allowed to withdraw their capital contribution after the company has been registered with the company registration authority.[128] However, it is permissible for shareholders to transfer their capital contributions. In this regard, the Company Law has provisions different from the EJV Law and the EJV Implementation. Under the Company Law, shareholders may transfer their contributed capital to an outsider if a simple majority of shareholders agrees to the transfer,[129] and there is no requirement that the transfer be subject to the approval of a competent governmental department. Under the EJV Implementation, however, parties to an EJV must reach a consensus with all parties to the EJV and must get approval from the examination and approval agency before transferring all or any part of their investment in the EJV to a third party.[130]

The Company Law also provides that a shareholder who does not agree to the transfer of capital contribution by another shareholder may purchase the capital; failure to do so will be regarded as approval of the transfer.[131] This provision deprives a financially weak shareholder of the right to say no to a proposed transfer of capital contribution, and therefore shareholders can always transfer their capital contribution if they wish. However, since the conflicting provisions of laws regarding EJVs prevail over the Company Law, an EJV-type limited liability company should abide by the consensus requirement.

B. Companies Limited by Shares

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125. *Id.* art. 30.
126. *Id.*
127. *Id.* art. 31.
128. *Id.* art. 34.
129. *Id.* art. 35.
130. EJV Implementation, *supra* note 17, art. 23.
131. Company Law, *supra* note 1, art. 35.

The national and local interim regulations issued in 1992 on Limited Liability Companies and Companies Limited by Shares, which have been replaced by the Company Law, constituted the basis for the legislation of the Company Law.[132] The Company Law, however, makes substantial changes to these regulations. With regard to whether the law governing limited liability companies and companies limited by shares would be applicable to the foreign-invested limited liability companies and companies limited by shares, for example, the rule under the Company Law is different from the interim regulations. The Standard Opinions on Companies Limited by Shares provide that companies limited by shares with foreign investment must abide by both these opinions and the relevant laws and regulations regarding foreign investment enterprises.[133] The Standard Opinions on Limited Liability Companies provide that limited liability companies with foreign investment are not subject to these standard opinions, but rather, to the EJV Law, the WFOE Law and the CJV Law.[134] The Company Law, however, provides that limited liability companies with foreign investment shall be bound by the Company Law except where the laws regarding EJVs, CJVs, and WFOEs regulate otherwise,[135] but deliberately leaves silent the same problem for companies limited by shares with foreign investment. Since the applicability of laws on EJVs, CJVs and WFOEs to companies limited by shares with foreign investment remains to be seen under the Company Law, the author will not refer to these relevant laws in the following discussions on companies limited by shares.

1. Conditions for the Formation of Companies Limited by Shares

To form a company limited by shares, six conditions must be met: (1) the number of promoters must satisfy the legal requirement; (2) the amount of share capital subscribed to by the promoters and offered to the public must comply with the statutory threshold; (3) share issuance and preparatory work must conform to the provisions of law; (4) the company's articles of association must be prepared by the promoters and subsequently passed at the founding general meeting; (5) the company must be named and there must be an organizational structure instituted in conformity with the requirements for a company limited by shares; and (6) the company must establish fixed sites for production and operation and meet the necessary conditions for such production and operation.[136]

There is a significant departure from previous legislation with regard to the requirement for the status of promoters. The Standard Opinions on Companies

132. *See supra* note 4 and accompanying text (listing some of the regulations).
133. Standard Opinions on Companies Limited by Shares, *supra* note 4, art. 115.
134. Standard Opinions on Limited Liability Companies, *supra* note 4, art. 78.
135. Company Law, *supra* note 1, art. 18.
136. *Id.* art. 73.

Limited by Shares provide that promoters of a company limited by shares must be legal persons within the territory of China, not including private enterprises and WFOEs.[137] It further provides that when EJVs are among the promoters, they must not account for one third of the promoters, and individuals are not allowed to be promoters.[138] In contrast, the Company Law has made significant progress toward the liberalization of foreign investment in the form of companies limited by shares. Article 75 of the Company Law provides that the establishment of a company limited by shares must have at least five promoters, of whom half must be domiciled within the territory of China.[139] No further limitation is imposed in this respect. Therefore, Chinese and foreign individuals and enterprises are now eligible to be promoters of a company limited by shares so long as the majority of the promoters have their domiciles in China. The legislative intent of Article 75 with respect to the Chinese participation requirement seems to limit the controlling power of foreign promoters by eliminating the possibility that a company limited by shares be formed by foreign promoters as the majority. As observed previously, there is no such requirement for a limited liability company.[140] Therefore, one question may be raised: Does the Chinese government have a greater policy interest in controlling an EJV-type company limited by shares, as opposed to an EJV-type limited liability company? One possible answer is that the shares of a company limited by shares may be traded in the stock exchanges, and the public may hold up to sixty-five percent of the shares of such a company.[141] Since it is related to the public interest, it becomes imperative for the Chinese government to ensure a certain level of control over a company limited by shares. However, promoters with foreign capital from a WFOE can still become controlling in a company limited by shares, even though promoters with foreign domiciles cannot.[142] From the author's standpoint, this is a kill-two-birds-with-one-stone mechanism. Foreign investors may still use their WFOEs in China to invest in companies limited by shares without limitation, thus the policy interest in encouraging foreign investment in companies limited by shares is in fact promoted. In addition, since these WFOEs are Chinese legal persons subject to complete Chinese control, their participation in companies limited by shares does not negate the necessary level of governmental control over companies limited by shares.

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137. Standard Opinions on Companies Limited by Shares, *supra* note 4, art. 10.

138. *Id.*

139. Company Law, *supra* note 1, art. 75.

140. *See supra* notes 89-99 and accompanying text (discussing the formation of limited liablity companies).

141. *See infra* notes 150-166 and accompanying text (describing the formation of companies limited by shares and the transfer of shares).

142. *See infra* notes 144-145 and accompanying text (discussing promoters with foreign capital in companies limited by shares).

Under the General Principles of the Civil Code of China[143] and the Company Law, the domicile of a legal person is consistently defined as the principal place of business,[144] and thus various foreign investors may use their wholly-owned subsidiaries whose principal places of business are in China to act as majority promoters in a company limited by shares. In addition, the Company Law only limits the number of promoters with foreign domiciles, but does not limit the percentage of capital contribution by foreign promoters. Further, since the Company Law does not limit the proportion of *de facto* foreign capital in a company limited by shares, a company limited by shares may be formed exclusively by more than five WFOEs in China as the promoters. However, there is an exception to the statutory number of promoters under the Company Law where a state-owned enterprise is reorganized into a company limited by shares. In this case, the number of promoters may be less than five, but such a company limited by shares must be formed by means of a public share offer,[145] which is one of the methods for formation of a company limited by shares discussed below.

The threshold for share capital is found in Article 78 of the Company Law, which provides that the minimum amount of registered capital for a company limited by shares is RMB10,000,000 yuan.[146] The registered capital is defined as the total amount of paid-in share capital registered by the company registration authority.[147] Article 78 of the Company Law also provides possible higher criteria by stating that if the minimum amount of registered capital of a company limited by shares needs to exceed the above-mentioned amount, it shall be specified otherwise by future laws and regulations.[148]

While there is no specific requirement of governmental approval in the formation of a limited liability company under the Company Law, the formation of a company limited by shares is subject to governmental approval, which can be granted by a department authorized by the State Council or by the government of the People's Republic of China at the provincial level.[149]

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143. *Zhonghua Renmin Gonheguo Minfa Tongzhe* [General Principles of the Civil Code of the PRC], *reprinted in* COMPILATION OF LAWS AND REGULATIONS FOR NATIONAL BAR EXAMINATION OF 1993, at 222 (Ministry of Justice of China ed., Economic Administration Publishing House 1993).

144. Company Law, *supra* note 1, art. 10; General Principles of the Civil Code of P.R.C., *supra* note 143, art. 39.

145. Company Law, *supra* note 1, art. 75.

146. *Id.* art. 78. *See supra* note 28 and accompanying text (discussing the exchange rate between Chinese Renminbi and the US dollar).

147. Company Law, *supra* note 1, art. 78.

148. *Id.*

149. *Id.* art. 77.

2. *Methods for the Formation of Companies Limited by Shares*

Under the Company Law, there are two ways to form a Company Limited by Shares: the promotion method and the public share offer method.[150] The promotion method requires promoters to "subscribe to and purchase all of the shares issued by the company for its formation," whereas the public share offer method necessitates that promoters subscribe to and purchase a portion of the shares issued by the company for its formation and that the balance be offered to the public.[151] Where a company limited by shares is formed through the public share offer method, promoters must subscribe to and purchase at least thirty-five percent of the shares, with the balance (sixty-five percent) offered to the public.[152]

a. Public Share Offer

It should be noted that promoters are prohibited from offering shares to the public without permission from the Securities Administration Department of the State Council.[153] Though the specific name of this department remains to be clarified by the implementation rules of the Company Law which will be promulgated by the State Council, the Interim Regulations on the Issue and Trading of Shares of the State Council (Interim Regulations on Shares)[154] have regulated the governmental authorities in charge of the national stock market. Under the Interim Regulations on Shares, the China Securities Regulatory Commission (CSRC), an executive agency of the State Council Securities Policy Committee (SCSPC), is responsible for administration, supervision and regulation of the national securities market.[155] Therefore, the Securities Administration Department under the Company Law should also be the CSRC.

The Company Law gives the Securities Administration Department under the State Council absolute authority in approving the share offer. A previously-granted approval of a share offer may be revoked before or after the share offer

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150. *Id.* art. 74.
151. *Id.*
152. *Id.* art. 83.
153. *Id.* art. 84.
154. Interim Regulations on the Issue and Trading of Shares of the State Council, *reprinted in* S. CHINA MORNING POST, June 8, 1993 (Business) at 4, *available in* LEXIS, News Library, Papers File. These rules provide formal nationwide standards for stock transactions in China before a complete securities statute is enacted. They address such matters as stock issues and trading; takeovers; custody, clearance, and registration of shares; information disclosure; inspection and penalties; and dispute resolution. *Id.* They also establish a national set of rules that pave the way for listing Chinese domestic stocks on foreign stock exchanges. *Id.* For an introduction to these regulations, see Pitman B. Potter, *P.R.C. State Council Issues National Stock Regulations*, 15 E. ASIA EXECUTIVE REP. 9 (1993). For an insightful and thorough discussion of the regulatory regime and institutional control of Chinese securities markets and foreign access to China's securities markets, see Pitman B. Potter, *The Legal Framework for Securities Markets in China: The Challenge of Maintaining State Control and Inducing Investors Confidence*, 7 CHINA L. REP. 61 (1992). *See also* Pitman B. Potter, *Securities Regulation: A National System Begins to Emerge*, 15 E. ASIAN EXECUTIVE REP. 5, May 15, 1993, at 9.
155. Company Law, *supra* note 1, art. 5.

begins if the share offer is deemed inconsistent with provisions of the Company Law.[156] Where an approval is revoked after a share offer has begun, promoters must return the share payment plus banking deposit interest for the period in question to share subscribers.[157] This strict governmental control certainly poses a risk for promoters and increases the unpredictability for company formation. However, one commentator on the Company Law has pointed out that from a long-term perspective, the benefit of the governmental approval system will outweigh the disadvantages, since it will be helpful in strengthening supervision over companies limited by shares and forcing them to move towards standardization.[158]

When applying for share offers, promoters must submit the following documents to the Securities Administration Department of the State Council: (1) approval documents for the formation of the company; (2) the company's articles of association; (3) an estimate of future earnings; (4) names of promoters, the amount of shares subscribed to and purchased by the promoters, types of capital contribution and a capital verification certificate; (5) a prospectus; (6) the name and address of the bank collecting share payment on promoters' behalf; and (7) the name of the securities organization contracting for the sale of shares, and the relevant agreement signed for the sale of shares.[159]

The Company Law allows a company limited by shares to offer its shares abroad but does not provide sufficient guidance.[160] Article 85 of the Company Law provides that overseas share offers must be subject to the approval of the Securities Administration Department of the State Council, and the specific measures shall be promulgated by the State Council.[161]

Promoters are required to disclose a prospectus and to prepare subscription forms.[162] A prospectus must be attached with articles of association of the company and must state the following items: (1) the amount of shares subscribed to and purchased by the promoters; (2) par value and issuing price of each share; (3) the total amount of bearer shares issued; (4) rights and obligations of subscribers; and (5) starting and ending dates for the share offer and a statement that subscribers may withdraw their share subscriptions if promoters fail to have shares subscribed in full within the time limit.[163] The subscription form must

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156. *Id.* art. 86.
157. *Id.*
158. *See* Li Yingning, *Standardization Needed for Balance*, S. CHINA MORNING POST, Feb. 14, 1994 (Business), at 2, *available in* LEXIS, News Library, Papers File. In this comment, Professor Li, head of Beijing University Department of Economics and a member of the Standing Committee of the NPC, one of the drafters of the Company Law, expressed the point that the removal of the approval mechanism in the introductory stage of a shareholding system in China is just a matter of time. *Id.*
159. Company Law, *supra* note 1, art. 84.
160. *Id.* art. 85.
161. *Id.*
162. *Id.* art. 88.
163. *Id.* art. 87.

include the above-mentioned items, and each subscriber must supply the number and amount of his subscribed shares and his domicile on the subscription form.[164] After all the requirements are met, promoters need to sign a consignment sales agreement with a legally established securities exchange organization to offer shares to the public.[165] Meanwhile, they are required to sign a share payment collection agreement with a bank, which shall, on the promoters' behalf, collect and hold share payment and render a receipt to subscribers who have paid in their shares.[166]

b. Capital Contribution by Promoters

The terms and conditions for capital contribution by promoters in companies limited by shares are similar to those applicable to limited liability companies. The promoters can contribute their capital by currency or tangible property, industrial property right, nonpropriety technology and land use rights.[167] The value of the industrial property right and nonpropriety technology used for capital contribution must not exceed twenty percent of the registered capital of a company limited by shares.[168]

3. Founding General Meeting (Chengli Dahui)

Where the promotion method is used to form a company limited by shares, the promoters may elect the board of directors and the board of supervisors right after the subscribed capital has been fully paid in, and the board of directors is then responsible for handling the procedure of company registration.[169] But where the share offer method is used, a founding general meeting is required.[170]

After the issued shares have been fully paid in the share offer, a capital verification certificate issued by a statutory capital verification institution is required.[171] Further, within thirty days after the issued shares have been fully paid in, the promoters must convene a founding general meeting, which is to consist of all share subscribers.[172] If the promoters fail to convene this meeting within this mandatory time limit, or if the issued shares are not subscribed in full within the time limit provided in the prospectus, the subscribers may request that the promoters refund the share payments plus the banking depository interest for the

164. *Id.*
165. *Id.* art. 89.
166. *Id.* art. 90.
167. *Id.* art. 80.
168. *Id.*
169. *Id.* art. 82.
170. *Id.* art. 91.
171. *Id.*
172. *Id.*

period in question.[173] The promoters are required to notify each shareholder or to make a public announcement about the date of the meeting, at least fifteen days prior to the convening of the meeting.[174] The Company Law specifies a quorum for a founding general meeting to be held. Share subscribers representing more than one half of the total number of shares must be present at the meeting.[175]

4. Registration for Establishment of Companies Limited by Shares

If the company limited by shares is formed through the promotion method, the board of directors elected by the promoters must submit the approval document, articles of association and capital verification certificate to the company registration authority to apply for registration.[176] There is no prescribed time limit for registration in this case. However, where the share offer method is applied, the Company Law mandates that the board of directors must, within thirty days after the conclusion of the founding general meeting, apply for the registration of formation by submitting the following documents to the company registration authority: (1) approval documents from relevant competent authorities; (2) minutes of the founding general meeting; (3) articles of association; (4) financial auditing report on preparatory work for the formation of the company; (5) capital verification certificate; (6) names and domiciles of members of the board of directors and the board of supervisors; and (7) name and domicile of the legal representative.[177] Moreover, the Company Law also requires the company registration authority to make its decision within thirty days after receipt of the application.[178] A business license is issued to the company limited by shares if the company registration authority approves the application.[179] The issuing date of the business license is the date for the establishment of the company, and the company is required to make a public announcement upon its establishment.[180] If the company is formed through the share offer method, it must also file a report

173. *Id.*
174. *Id.* art. 92.
175. *Id.* The founding general meeting may adopt resolutions on the following matters by a simple majority of voting rights of share subscribers present at the meeting: (1) the review of the promoter's report about the preparatory work for the company's formation; (2) the adoption of the company's articles of association; (3) the election of the members to the board of directors; (4) the election of the members to the board of supervisors; (5) the verification of the expenditure for the formation of the company; (6) the verification of the price evaluation of the property used by promoters for capital contribution; (7) the resolution not to form the company if *force majeure* or a substantial change in operational conditions has a direct impact on the formation of the company. *Id.*
176. *Id.* art. 82.
177. *Id.* art. 94.
178. *Id.* art. 95.
179. *Id.*
180. *Id.*

about the details of the share offer with the Securities Administration Department of the State Council for record-keeping purposes.[181]

5. *Legal Liabilities of Promoters*

The interests of share subscribers and other kinds of creditors will be at risk if the promoters fail to establish the proposed company limited by shares. The Company Law safeguards these legitimate interests by imposing rather heavy liabilities on the promoters. Where the proposed company fails to become established, the promoters are jointly and severally liable for the indebtedness and expenditures incurred from the formation activities, and for the refunding of the share payment already made by subscribers, plus the banking deposit interest for the period in question. One question, though, remains to be answered in the Company Law. If the share subscribers, pursuant to Article 92 of the Company Law, vote at the general founding meeting not to establish the proposed company because of a *force majeure* or a substantial change in operational conditions having a direct impact on the formation of the company,[182] will the promoters still bear this kind of joint and several liability? The language in Article 97 of the Company Law does not provide any excuse for the promoter in this respect. In contrast, the same article of the Company Law stipulates that if the company, during its course of formation, suffers losses and damages attributable to the promoters' negligence, the promoter shall compensate the company accordingly.[183] Therefore, the plain language of Article 97 seems to indicate that the promoters' joint and several liability for indebtedness, expenditures, and share payment is a form of strict liability, even if the the share subscribers vote not to establish the company. However, the problem still exists where the promoters' at the founding general meeting oppose the decision not to establish the company. The implementation rules of the Company Law thus need to further elaborate on this issue.

6. *Transformation of Limited Liability Companies to Companies Limited by Shares*

The Company Law allows limited liability companies to reorganize as companies limited by shares. The general principle is that the conditions under the Company Law for a company limited by shares must be met, and the formation procedures for a company limited by shares must be followed.[184] After

181. *Id.*
182. *Id.* art. 97.
183. *Id.*
184. *Id.* art. 98.

the transformation, the new company limited by shares must bear all of the debts receivable and debts payable of the original limited liability company.[185]

In a transformation, the total converted amount of shares should be equivalent to the value of the net assets of the limited liability company.[186] If the company limited by shares transformed from a limited liability company needs to increase its capital by means of a share offer, provisions of the Company Law regarding share offers must apply.[187]

7. Share Issuance

Substantial progress has been made in the Company Law in the standardization of share issuance. In the Standard Opinions on Companies Limited by Shares, shares are classified into four types: the State shares held by the governmental investment bodies; the legal person shares held by legal persons; the individual shares held by individuals, with the limitation that an individual shall not hold more than 0.5 percent of the total amount of company shares; and the foreign capital shares held by investors from foreign countries, Hong Kong, Macao, and Taiwan.[188] Moreover, there are two general kinds of shares under these opinions: the "A shares" and the "B shares."[189] Foreign investors and investors from Hong Kong, Macao and Taiwan may not purchase or trade the "A shares," which must be denominated in Renminbi and purchased and traded only by Chinese citizens.[190] Foreign investors may only purchase the "B shares" which are defined as special shares denominated in Renminbi but purchased and traded by foreign investors in foreign currency.[191] Chinese citizens are not allowed to purchase and trade the "B shares."[192] In contrast, the Company Law standardizes the classification of shares by providing only two types of shares: registered shares and bearer shares.[193] The Company Law does not specifically provide definitions of registered shares and bearer shares. But, as the following discussion indicates, the registered shares are share certificates where the names and residences of shareholders must be recorded in the company's shareholder register, and the transfer of them must be endorsed by the transferring

185. *Id.* art. 100.
186. *Id.* art. 99.
187. *Id.*
188. Standard Opinions on Companies Limited by Shares, *supra* note 4, art. 24.
189. *Id.* art. 29.
190. *Id.*
191. *Id.*
192. *Id.*
193. Company Law, *supra* note 1, art. 133.

shareholder, whereas the company does not need to record the names and residences of holders of bearer shares and they can be transferred by simply being handed over to transferees at a stock exchange.[194]

Under the Company Law, the capital of a company limited by shares must be divided into shares with equal value for each share.[195] Shares issued to promoters, governmental investment bodies and legal persons must be in the form of registered shares, and shares issued to the public can be either registered shares or bearer shares.[196] Shares must be issued in the form of share certificates,[197] and the same types of shares must carry the same rights and benefits.[198] Shares of the same issue must be issued with the same conditions and at the same prices.[199] Companies that issue registered shares are obligated to establish a shareholders' register in which the following details must be recorded: (1) the names and domiciles of the shareholders; (2) the number of shares held by each shareholder; (3) the serial numbers of the share certificates held by each shareholder; and (4) the date on which the shares were obtained by each shareholder.[200] Companies issuing bearer shares must record the number, serial numbers and date of issuance on their share certificates.[201]

The Company Law does not specify the statutory minimum amount for the par value of shares. It instead provides that shares may be issued at or above par value, but not below.[202] If a company issues shares above par value, it is required to obtain approval from the Securities Administration Department of the State Council.[203]

8. Transfer of Shares

Shares are transferrable under the Company Law, but must be transferred at stock exchanges established according to law.[204] Registered shares must be transferred through endorsement by shareholders or through other means specified by laws and administrative regulations.[205] The name and domicile of the transferee of registered shares must be recorded by the company in the

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194. *See infra* notes 204-209 and accompanying text (discussing the shareholders' register and the transfer of shares).
195. Company Law, *supra* note 1, art. 129.
196. *Id.* art. 133.
197. *Id.* art. 129.
198. *Id.* art. 130.
199. *Id.*
200. *Id.* art. 134.
201. *Id.*
202. *Id.* art. 131.
203. *Id.*
204. *Id.* arts. 143-44.
205. *Id.* art. 145.

shareholders' register.[206] As to bearer shares, the transfer will be effective after a shareholder hands the shares over to the transferee at a stock exchange established according to law.[207]

Shares held by promoters of the company may not be transferred for at least three years from the date of establishment of the company.[208] The directors, supervisors and managers of a company must disclose to the company the number of company shares they hold and may not transfer such shares while they are in office.[209] This is meant to bind these company officials to the interests of the company, but it is not clear whether all these company officials are mandated to hold the company's shares. In addition, the Company Law does not provide a minimum or maximum limit to shares held by these officials.

9. *Listed Companies*

A listed company is defined as a company limited by shares whose issued shares are listed and traded on stock exchanges upon approval by the State Council or by the Securities Administration Department authorized by the State Council.[210] Upon approval by the Securities Administration Department under the State Council, the listed company must prepare a report on its share listing and make its application documents available at a designated place.[211] Furthermore, the listed company has the obligation to regularly disclose details of its financial position and business as required by law, and it must publish a financial and accounting report once every six months of each fiscal year.[212]

Article 85 of the Company Law allows a company limited by shares to offer shares abroad for its formation, whereas Article 155 provides that a company

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206. *Id.*
207. *Id.* art. 146.
208. *Id.* art. 147.
209. *Id.*
210. *Id.* art. 151. The Company Law specifies the following conditions that a company limited by shares must satisfy in order to obtain an approval to list its shares in stock exchanges: (1) the securities administration department of the State Council must have approved the issuance of shares to the public; (2) the total amount of the company's share capital is least RMB 50,000,000 yuan; (3) the company must have commenced business for more than three years before the date of application for listing and have been continuously profitable for the immediately preceding three years; a special provision in this regard is that if a company limited by shares is established through the transformation of a state-owned enterprise, or if a company limited by shares is newly established with large or medium-size state-owned enterprises as principal promoters, the period of time prior to the transformation or new establishment of the company may be included in the calculation of such three-year requirement; (4) the number of shareholders holding shares whose par value amounts to RMB 1000 yuan or more must be at least 1000, and shares issued to the public must represent 25% or more of the company's total shares; if the company's total share capital exceeds RMB 400,000,000 yuan, the portion of shares issued to the public must exceed 15%; (5) the company must not have committed any serious illegal acts during the last three years, and its financial accounting reports must not contain any false entries; and (6) other conditions as provided by the State Council. *Id.* art. 152.
211. *Id.* art. 153.
212. *Id.* art. 156.

limited by shares may list its shares at overseas stock exchanges upon approval by the Securities Administration Department of the State Council.[213] While the State Council still needs to elaborate details, these provisions have built a legal basis for Chinese companies to enter international stock markets, and allow Chinese companies to be more closely linked with the international economy.

However, the listing of shares may also be suspended or even terminated by the Securities Administration Department of the State Council.[214] The listing of a company's shares may be suspended if one of the following situations exists: (1) the company no longer satisfies listing conditions due to a change in its total share capital or the holding of its shares; (2) the company fails to disclose details of its financial position or makes false entries in its financial and accounting reports; (3) the company has committed a major illegal act; or (4) the company has continuously suffered losses during the past three consecutive years.[215]

If the circumstances leading to the suspension of listing are more serious, the Securities Administration Department of the State Council may terminate a company's listing in stock exchanges. Specifically, the termination of listing may be triggered if: (1) there are serious consequences resulting from the company's failure to disclose details of its financial position, the company's false entries in its financial and accounting reports, or the company's commission of a major illegal act; or (2) the company is no longer qualified to be listed due to changes in the total share capital or the holding of its shares, or due to its continuous losses during the past three consecutive years, and the company cannot rectify this situation within a time limit.[216] In addition, termination of listing may occur if: (1) the company passes a resolution to dissolve itself; (2) a competent administrative authority orders the company to dissolve according to law; or (3) the company is declared bankrupt.[217]

10. Company Bonds

Company bonds are defined as valuable commercial papers issued by a company in accordance with statutory procedure, the principal of which such company agrees to repay, together with interest, within a definite time limit.[218] The Company Law allows three types of companies to issue company bonds for the purpose of raising production and operating funds: companies limited by shares, wholly state-owned companies,[219] and limited liability companies formed

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213. *Id.* art. 155.
214. *Id.* arts. 157-58.
215. *Id.* art. 157.
216. *Id.* art. 158.
217. *Id.*
218. *Id.* art. 160.
219. *Id.* art. 64. A wholly state-owned company is a special type of limited liability company under the Company Law. *Id.* It is defined in Article 64 of the Company Law as a limited liability company formed and invested exclusively by one state authorized investment entity or one state authorized department. *Id.*

by two or more state-owned enterprises or by two or more other state-owned investment entities.[220] Therefore, a limited liability company with foreign investment is excluded from issuing company bonds under the Company Law.

The issuance of company bonds is subject to examination and approval by the Securities Administration Department of the State Council.[221] As a holdover from the planned economy, the State Council is to determine a quota for the nationwide issuance of company bonds.[222] Before company bonds may be issued, the following conditions must be met: (1) net assets must be at least RMB 30,000,000 yuan for a company limited by shares, and RMB 60,000,000 yuan for a qualified limited liability company; (2) the aggregate total amount of the bonds issued may not exceed forty percent of the company's net assets; (3) the average distributable profits of the company for the immediately preceding three years must be sufficient to pay one year's interest on company bonds; (4) the application of the proceeds from the issuance of the bonds must be in compliance with State industrial policies; (5) the bond interest rate may not exceed the level determined by the State Council; and (6) other conditions as specified by the State Council.[223]

The documents used in the application for issuing company bonds include the certificate of company registration, the articles of association of the company, the report on subscription method of company bonds, and the reports on asset evaluation and capital verification.[224] After approval is obtained, the company is required to disclose the subscription method report, which must state such particulars as the name of the company, the total amount of company bonds, the face value of the bond, the interest rate, time limit and method of repayment, amount of net assets of the company, total amount of undue bonds previously issued, and the securities exchange organizations contracting for the sales of bonds.[225]

It should be noted that the Company Law restricts the ways under which a company may use the proceeds from issuing company bonds. The proceeds must be used in accordance with the purpose stated in the company's application to the authority for approval of issuance, and may not be used to cover losses or for nonproduction expenditures.[226]

As shares, company bonds are also divided into two types: registered bonds and bearer bonds. The transfer of company bonds are again similar to those

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220. *Id.* art. 159.
221. *Id.* art. 163.
222. *Id.* art. 164.
223. *Id.* art. 161. *See supra* note 28 and accompanying text (discussing the exchange rate between Chinese Renminbi and US dollars).
224. Company Law, *supra* note 1, art. 165.
225. *Id.* art. 166.
226. *Id.* art. 161.

governing the transfer of shares.[227] One important difference, however, is that the price of company bonds is negotiated between the transferor and the transferee.[228]

Another feature about the rules concerning company bonds which is worth mentioning is that listed companies are allowed to issue convertible company bonds which may be converted into shares.[229] The method of conversion must be specified in the offering measures for the company bonds.[230] An approval from the Securities Administration Department of the State Council is required for the issuance of convertible company bonds.[231]

Companies issuing convertible company bonds must satisfy both the conditions for the issuance of shares and the conditions for the issuance of company bonds.[232] In order to differentiate the convertible company bonds from the ordinary ones, the words "convertible company bond" must be mentioned on the bonds.[233] While the company issuing company bonds must issue share certificates to bondholders according to the conversion method, bondholders have the option to choose whether or not to convert their bonds into shares.[234]

C. *Branches of Foreign Companies*

Under the Chinese legal regime before the adoption of the Company Law, a foreign investor was allowed to directly engage in production and operational activities only by forming an EJV, CJV or WFOE.[235] Although a foreign investor was also allowed to establish a "resident representative office of foreign enterprise" *(waiguo qiye changzhu daibiao jigou),* such resident representative office was not allowed to engage in "direct operating activities" except where an international treaty to which China is a party provides otherwise.[236] Therefore, a resident representative office can only engage in liaison activities and is prohibited from, inter alia, concluding sales contracts, manufacturing, conducting marketing or providing after-sales services.[237] Considering this background, one may indeed conclude that the Company Law has made a breakthrough by

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227. *Id.* arts. 168, 170-71.
228. *Id.* art. 170.
229. *Id.* art. 172.
230. *Id.*
231. *Id.*
232. *Id.*
233. *Id.*
234. *Id.* art. 173.
235. Since a resident representative office of foreign enterprise was not allowed to engage in direct operational activities, the EJV, CJV, and WFOE became the only forms. *See infra* notes 236-266 and accompanying text (discussing the resident representative office of foreign enterprise).
236. Procedures of the State Administration for Industry and Commerce of the People's Republic of China Concerning the Registration and Administration of Resident Representative Offices of Foreign Enterprises, art. 3, *reprinted in* 2 CHINA'S FOREIGN ECONOMIC LEGISLATION 218 (Foreign Press 1984) [hereinafter Resident Office Registration Procedures].
237. *Id.* art. 15. Article 15 stipulates that if a foreign enterprise resident representative office violates the provisions of Article 3 of the Procedures and directly engages in operating activities, it shall be ordered to cease its operating activities and shall be subject to a fine of not more than RMB 20000 yuan. *Id.*

specifying that a foreign company may establish its branches within the Chinese territory to engage in production and operation activities.[238] The clear meaning of "production and operational activities," however, still needs to be elaborated further in the detailed implementation rules of the Company Law.

1. Legal Status of Branches of Foreign Companies

The Company Law, for the first time, provides principles and rules for branches of foreign companies (*waiguo gongsi fenzhi jigou*),[239] whose name itself is also new in Chinese legislation. Foreign companies are defined in the Company Law as companies incorporated outside the Chinese territory in accordance with a foreign country's law.[240] Foreign companies are specified as foreign legal persons, and their branches established in China do not have the status of Chinese legal persons.[241] Foreign companies must bear the civil liabilities for the business activities carried out in China by their branches.[242]

While branches of foreign companies are no longer prohibited from engaging in production and other business in China, it remains to be seen whether resident representative offices of foreign enterprises formed under the Interim Provisions of the State Council of the PRC for the Control of Resident Representative Offices of Foreign Enterprises (Interim Provisions for Resident Offices),[243] which was issued in 1980, one year after the beginning of the opening-up policy, will be automatically regarded as branches of foreign companies permitted to be involved in direct business, or will be retained as yet another different form of business association. Although it is expected that the State Council will clarify this issue in the detailed rules for the implementation of the Company Law, the author's opinion is that the existing resident representative offices of foreign companies may not need to submit new applications to examination and approval authorities. They may, however, be required to apply to the company registration authority to change their business licenses to those for branches of foreign companies. In all likelihood, the company registration authority will grant new licenses to them if the conditions for branches of foreign companies under the Company Law have already been met. Since resident representative offices have been approved by the competent examination and approval authorities,[244] as a

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238. Company Law, *supra* note 1, art. 199.

239. The direct literal translation of this Chinese term is "division and subdivision organizations of foreign companies."

240. Company Law, *supra* note 1, art. 199.

241. *Id.* art. 203.

242. *Id.*

243. Interim Provisions of the State Council of the PRC for the Control of Resident Representative Offices, *reprinted in* 1 CHINA'S ECONOMIC FOREIGN LEGISLATION 166 (Foreign Language Press 1984) [hereinafter Interim Provision for Resident Offices].

244. *See infra* notes 245-256 and accompanying text (discussing the examination and approval authorities of resident representative offices).

practical matter, there is little need to go through the whole examination and approval procedure again.

2. *Approval and Registration of Branches of Foreign Companies*

To establish a branch in China, a foreign company must file an application with the proper Chinese authority and submit such relevant documents as the articles of association of the company and the company registration certificate issued by its home country.[245] Upon approval, it must carry out registration procedures with the Chinese company registration authority and obtain a business license.[246] While the Company Law does not spell out the detailed rules for the approval and registration procedures which will be promulgated by the State Council,[247] the existing provisions governing resident representative offices of foreign enterprises, may include important parameters for the future State Council regulations. These existing provisions include the Interim Provisions for Resident Offices and the Procedures of the State Administration for Industry and Commerce of the PRC concerning the Registration of Resident Representative Offices of Foreign Enterprises (Resident Office Registration Procedures) promulgated in 1983.[248]

Under the Interim Provisions for Resident Offices, a foreign enterprise is required to submit the following documents and materials when applying to establish a resident representative office in China: (1) an application signed by the chairman of the board of directors or the president of the enterprise, which includes the name of the resident representative office, its leading personnel, its business scope, its term of residence, its location, etc.; (2) an official business license issued by the pertinent authorities of the country or region where the enterprise is located; (3) a credit-standing certificate issued by a financial institution that has business dealings with the enterprise; and (4) a letter of authorization and a resume for each of the personnel appointed by the enterprise to the resident representative office.[249]

The Interim Provisions for Residence Offices imposes extra requirements for financial and insurance companies, probably because the Chinese government was more concerned with the stability and security of the financial sector. These companies must, in addition to submitting the above-mentioned documents in items (1), (2) and (4), submit at the same time an annual report by the head office setting forth the assets, liabilities, profits and losses of the company, its articles of association, and a list of the members of its board of directors.[250] It should be

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245. Company Law, *supra* note 1, art. 200.
246. *Id.*
247. *Id.*
248. Resident Office Registration Procedures, *supra* note 236.
249. Interim Provisions for Resident Offices, *supra* note 243, art. 3.
250. *Id.*

noted that under the Company Law, the articles of association of the company are required in all cases.[251]

The authorities who will be in charge of examining and approving branches of foreign companies are also not specified under the Company Law. The Interim Provisions for Resident Offices divides companies into five categories according to their industries and designates corresponding governmental departments to take charge of approval: (1) import and export traders, manufacturers and shipping agents shall apply to the Ministry of Foreign Trade[252] of the PRC for approval; (2) financial and insurance companies shall apply to the People's Bank of China (PBOC) for approval; (3) ocean shipping companies and ocean shipping agents shall apply to the Ministry of Communications of the PRC for approval; (4) air transport companies shall apply to the General Administration of Civil Aviation of China (CAAC) for approval; and (5) other industries, in accordance with the nature of their businesses, shall apply to the proper commission, ministry or bureau of the PRC government for approval.[253]

After a foreign enterprise obtains approval, it is required to present the approval certificate within thirty days of the date of approval to the State Administration for Industry and Commerce of the PRC and complete the registration procedures, filling out the registration forms, paying a registration fee and obtaining a registration certificate (i.e., business license).[254] The Residence Offices Registration Procedures provide that when applying for registration, a foreign enterprise shall, in addition to submitting documents mandated under the Interim Provisions for Resident Offices, submit the approval certificate issued by a competent authority.[255]

3. *Operations of Branches of Foreign Companies*

The branch of a foreign company must abide by the laws of China and refrain from harming the public interest of China.[256] Its legitimate rights and benefits shall be protected by the laws of China.[257] Foreign companies are required under the Company Law to designate a representative or an agent in charge of their branch.[258] There is no limitation on the nationality of the managerial personnel for the branch, and therefore the representative or agent may either be of Chinese or foreign nationality. The branch of a foreign company must indicate in its name

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251. Company Law, *supra* note 1, art. 200.
252. This name has been changed to the Ministry of Foreign Trade and Economic Co-operation (MOFTEC).
253. Interim Provisions for Resident Offices, *supra* note 243, art. 4.
254. *Id.* art. 5.
255. Resident Offices Registration Procedures, *supra* note 236, art. 7.
256. Company Law, *supra* note 1, art. 204.
257. *Id.*
258. *Id.* art. 201.

the foreign company's nationality and the form of liability, and a copy of the articles of association of the foreign company must be kept on the business premises of its branch.[259] In addition, the foreign parent company or head office is required to appropriate to its branch an amount of capital "compatible with its operational and business activities."[260] The Company Law does not elaborate on the specific requirement concerning the capital of the branch of a foreign company, but authorizes the State Council to promulgate provisions on the minimum amount of capital thereof if necessary.[261] Further, when a foreign company cancels its branch in China, it is required to settle the debts of the branch and carry out liquidation according to the Company Law.[262] Before the liquidation of debts, the foreign company is prohibited from transferring the assets of the branch out of China.[263] Finally, the Company Law imposes a rather strict legal liability on a foreign company which establishes a branch in China without proper approval.[264] If this is the case, the foreign company will be ordered to rectify the situation or close the branch.[265] In addition, the foreign company may be ordered to pay a fine of not less than RMB 10,000 yuan and not more than RMB 100,000 yuan,[266] which is a kind of penalty imposed by the Chinese administrative authority. The scope of this authority still needs to be specified.

IV. A COMPARATIVE REVIEW OF THE ORGANIZATIONAL STRUCTURES FOR LIMITED LIABILITY COMPANIES AND COMPANIES LIMITED BY SHARES

Generally speaking, the organizational structures of limited liability companies and companies limited by shares are the same, with both having a shareholders' meeting, board of director, board of supervisors, and the managerial personnel headed by the general manager (or manager). This section will discuss the organizational structure common to both companies, and will examine the differences between the two where appropriate.

A. Shareholders' Meeting

In companies limited by shares, the highest organ of authority is the shareholders' general meeting *(gudong dahui),* while in limited liability companies, the organ with the same functions and authorities is called the

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259. *Id.* art. 202.
260. *Id.* art. 201.
261. *Id.*
262. *Id.* art. 205. Under Chapter 8 of the Company Law, liquidation may be carried out under three circumstances: bankruptcy, dissolution, and being ordered to close. *Id.* arts. 189-92.
263. *Id.*
264. *Id.* art. 226.
265. *Id.*
266. *Id. See supra* note 28 and accompanying text (discussing the exchange rate between Chinese Renminbi and US dollars).

shareholders' meeting *(gudong hui).*[267] In the following text, these two terms will be collectively referred to as the shareholders' meeting.

1. Functions and Authorities of Shareholders' Meeting

Except in the case of wholly State-owned limited liability companies exclusively invested in by the Chinese government,[268] the shareholders' meeting is a mandatory organ for both limited liability companies and companies limited by shares.[269] The shareholders meeting has the following common functions and authorities under the Company Law: (1) to decide the company's operational principles and investment plans; (2) to elect and remove directors and supervisors, and to decide their remunerations; (3) to examine, discuss and approve the reports from the board of directors and the board of supervisors, the company's annual financial budget plans and final accounting plans, and the company's profit distribution plans and loss recovery plans; (4) to make resolutions on the increase or reduction of the company's registered capital, the issuance of company bonds, and the matters such as company merger, division, transformation, dissolution and liquidation; and (5) to amend the articles of association of the company.[270] For limited liability companies, the shareholders' meeting has one more power: to make resolutions on the transfer of capital from a shareholder to a party who is not an existing shareholder.[271]

2. The Convening of the Shareholders' Meeting

In a limited liability company, the first shareholders' meeting is to be called and presided over by the shareholder with the largest capital contribution,[272] and thereafter, by the board of directors and presided over by the chairman of the board of directors.[273] By contrast, in a company limited by shares, since the board of directors has been elected by the founding general meeting, the shareholders' meeting is to be called by the board of directors and presided over by the chairman of the board of directors.[274]

In both cases, the term shareholders' meeting includes regular meetings and interim meetings.[275] However, the detailed provisions in the two cases are different. First, in a limited liability company, the regular shareholders' meeting

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267. Company Law, *supra* note 1, arts. 37 and 102.
268. *Id.* arts. 64 and 66.
269. *Id.* arts. 37 and 102.
270. *Id.* arts. 38 and 103.
271. *Id.* art. 38.
272. *Id.* art. 42.
273. *Id.* art. 43.
274. *Id.* art. 105.
275. *Id.* arts. 43 and 104.

will be convened in accordance with the provisions of the articles of association,[276] while in a company limited by shares, the regular shareholders' meeting is required to convene once every year, which is called the "annual meeting" *(nian hui)* under the Company Law.[277] Second, for limited liability companies, the convocation of an interim shareholders' meeting may be proposed by the shareholders representing more than one fourth of the voting rights or by more than one third of directors or of supervisors;[278] for companies limited by shares, the Company Law provides that an interim shareholders' meeting must be convened within two months should one of the following circumstances arise: (1) if the number of directors is less than two thirds of that provided in the Company Law or in the company's articles of association; (2) if the company's losses not yet recovered account for one third of the total amount of the share capital; (3) if shareholders holding ten percent or more of the company's shares propose to convene a meeting; (4) if the board of directors considers a meeting necessary; or (5) if the board of supervisors proposes to convene a meeting.[279] In both cases, if the chairman of the board of directors is not able to preside over the shareholders' meeting due to special reasons, the chairman is required to designate a vice chairman or director to preside over the meeting in his place.[280]

The time requirement for the notice of the meeting is different for limited liability companies and companies limited by shares. For limited liability companies, the Company Law provides that all of the shareholders must be notified of a shareholders' meeting fifteen days before the convening of the meeting;[281] whereas, for the company limited by shares, each shareholder must be informed of the matters that will be discussed at a meeting thirty days in advance of the meeting.[282] Moreover, the Company Law provides two other special requirements for companies limited by shares. First, an interim shareholders' meeting is not allowed to make resolutions on matters that are not listed on the notice.[283] Second, when a shareholders' meeting is to discuss the issuance of bearer shares, the company must make a public announcement about this matter forty-five days before the convening of the meeting.[284]

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276. *Id.* art. 43.
277. *Id.* art. 104.
278. *Id.* art. 43.
279. *Id.* art. 104.
280. *Id.* arts. 43 and 105.
281. *Id.* art. 44.
282. *Id.* art. 105.
283. *Id.*
284. *Id.*

3. *Decision-making of the Shareholders' Meeting*

In a limited liability company, a shareholder is to execute his voting rights in accordance with the proportion of his capital contribution.[285] For a company limited by shares, on the other hand, one share will represent one voting right.[286] In order to ascertain the identity of shareholders of a company limited by shares, the Company Law requires that the bearer-shareholders must hand over their share certificates to the company five days before the meeting and keep them in the company until the conclusion of the meeting.[287] For a company limited by shares, a shareholder may authorize an agent to attend a shareholders' meeting by signing a proxy, and the agent must present the proxy to the company and execute his voting right only pursuant to the authorization.[288]

In both limited liability companies and companies limited by shares, the minutes of the shareholders' meeting must be recorded.[289] The minutes must be signed, in the case of a limited liability company, by the shareholders present at the meeting, and in the case of a company limited by shares, by the directors present at the meeting.[290] In both cases, five important matters must be passed by shareholders representing two-thirds of the voting rights: (1) the increase or reduction of registered capital of the company; (2) the division of the company; (3) the merger of the company; (4) the dissolution of the company; and (5) the amendment to the company's articles of association.[291] A limited liability company is allowed to transform into a company limited by shares.[292] To do so, a special two-thirds majority of voting rights is required to pass the resolution on transformation of a limited liability company.[293] The voting requirement for other matters discussed at the shareholders' meeting is different. In the case of a limited liability company, the voting method for other matters may be provided by the company's articles of association,[294] while for companies limited by shares, resolutions on other matters discussed at a shareholders' meeting must be passed by a simple majority of voting rights represented.[295]

The legitimate rights of shareholders in a company limited by shares are further protected under the Company Law, which provides that if the share-holders' meeting or the board of directors passes a resolution in violation of the laws and administrative regulations, the shareholders have the right to file a proceeding in

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285. *Id.* art. 41.
286. *Id.* art. 106.
287. *Id.* art. 105.
288. *Id.* art. 108.
289. *Id.* arts. 44 and 109.
290. *Id.*
291. *Id.* arts. 39-40 and 106-07.
292. *Id.* art. 98.
293. *Id.* art. 39.
294. *Id.*
295. *Id.* art. 106.

the People's Court to stop the claimed illegality.[296] Shareholders in a company limited by shares also have the right to inspect the company's articles of association, minutes of shareholders' meetings, and financial accounting reports, and the right to raise inquiries into, and offer proposals for, the operation of the company.[297]

B. *The Board of Directors*

1. *Constitution, and Functions and Authority of the Board of Directors*

The constitutional process of the first board of directors in a limited liability company and a company limited by shares is different. For limited liability companies, the shareholder with the largest capital contribution shall call the first shareholders' meeting, which is to elect the members on the board of directors.[298] For companies limited by shares, the first board of directors is elected in the founding general meeting.[299] The continuous board of directors thereafter on both types of companies is elected by the shareholders' meeting.[300]

While the establishment of the board of directors under the Company Law is, without exception, mandatory for a company limited by shares, it is not mandatory for a limited liability company. If a limited liability company has a relatively small number of shareholders and a relatively small scale of business, it is not required to establish a board of directors, but instead may elect one executive director.[301] If a limited liability company is jointly invested in by foreign investors and Chinese partners, one should, in this regard, be aware of the EJV Implementation, which specifies the board of directors as the highest organ of authority of an EJV, the members of which must not be less than three.[302] The EJV Law and the EJV Implementation do not contain any exception to this mandate, and therefore a board of directors must be established in every EJV. Since this is a conflicting provision between the Company Law and the prevailing EJV Implementation, all EJV-type limited liability companies are required, in accordance with Article 18 of the Company Law, to set up a board of directors regardless of their size.

The statutory number of directors is different for the two types of companies. In the case of a limited liability company, it is from three to thirteen,[303] while in

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296. *Id.* art. 111.
297. *Id.* art. 110.
298. *See supra* notes 272-284 and accompanying text (discussing the shareholder meeting and limited liability companies).
299. *See supra* notes 272-284 and accompanying text (discussing the shareholder meeting and companies limited by shares).
300. Company Law, *supra* note 1, arts. 38 and 103.
301. *Id.* art. 51.
302. EJV Implementation, *supra* note 17, art. 34.
303. Company Law, *supra* note 1, art. 45.

the case of a company limited by shares, from five to nineteen.[304] However, in both cases, the board of directors is responsible for the shareholders' meeting,[305] and executes the same functions and authorities: (1) to convene and present its work reports to the shareholders' meeting; (2) to implement the resolutions of the shareholders' meeting; (3) to decide the company's operation and investment plans; (4) to formulate the company's annual financial budget plans and final accounting plans; (5) to formulate the company's profit distribution plans and loss recovery plans; (6) to formulate the company's plans for increasing or reducing the registered capital and issuing company bonds;[306] (7) to draft plans regarding mergers, separation and dissolution of the company; (8) to decide the establishment of the company's internal management mechanism; (9) to appoint or dismiss the company's manager, and based on the manager's nomination, appoint or dismiss the company's deputy manager and leading financial personnel, and decide their remunerations; and (10) to formulate the company's fundamental management system.[307]

In both cases, there will be one chairman and one or two vice chairmen of the board of directors.[308] For a limited liability company, the election method for chairman and vice chairman may be provided for by the company's articles of association.[309] According to the EJV Law, the chairman and vice chairman of the board shall be determined through consultation among the joint venturers or be elected by the board of directors.[310] The EJV Law further mandates that if the position of the chairman is held by a Chinese venturer, the position of the vice chairman must be held by a foreign venturer, and vice versa.[311] Thus, when providing the election method in the articles of association, a limited liability company with foreign investment should follow the rules of the EJV Law. For a company limited by shares, on the other hand, the members of the board of directors are to be elected by a simple majority of all members on the board of directors.[312] The term of office for directors in both kinds of companies under the

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304. *Id.* art. 112.

305. *Id.* arts. 46 and 112.

306. The formulation of the plan issuing company bonds is not listed in Article 46 of the Company Law dealing with the functions and authorities of the board of directors in a limited liability company. Article 163 of the Company Law dealing with the issuance of the company bonds, however, provides that such plan shall be formulated by the board of directors in both a company limited by shares and a limited liability company. *Id.* art. 163. Thus, if a limited liability company is permitted to issue company bonds, the authority of formulating the issuing plan belongs to the board of directors of the limited liability company. It should be noted that not all the limited liability companies are allowed to issue company bonds. As discussed earlier, only companies limited by shares, wholly state-owned companies, and limited liability companies established by two or more state-owned enterprises or governmental investment entities, may issue company bonds.

307. Company Law, *supra* note 1, arts. 46 and 112.

308. *Id.* arts. 45 and 113.

309. *Id.* art. 45.

310. EJV Law, *supra* note 6, art. 6.

311. *Id.*

312. Company Law, *supra* note 1, art. 113.

Company Law is to be provided by the articles of association but shall not exceed three years.[313] If reelected, a director may hold the position for additional consecutive terms.[314] Here again, the EJV Implementation has provisions different from the Company Law. The EJV Implementation provides that the term of office of directors is four years, but, as in the Company Law, there is no limitation on the consecutive terms if a director is reelected.[315]

2. *The Chairman of the Board of Directors*

The chairman of the board of directors, both in a limited liability company and in a company limited by shares, is the legal representative of the company.[316] Where a limited liability company does not have a board of directors, the executive director is the legal representative of the company, and shall execute the functions and authorities endowed to the board of directors.[317]

While the functions and authorities of the chairman of the board of directors in a limited liability company are not specified, the Company Law provides the following functions and authorities for the chairman in a company limited by shares: (1) to preside over the shareholders' meeting, and convene and preside over the meeting of the board of directors; (2) to examine the sufficiency of the implementation of the resolutions of the board of directors; and (3) to sign the company shares and company bonds.[318]

3. *Meetings of the Board of Directors*

The board of directors in a company limited by shares is required to convene at least twice annually.[319] While there is no such requirement for a limited liability company under the Company Law, the EJV Implementation specifies that the board meeting of an EJV must be convened at least once every year.[320] Both the Company Law and the EJV Implementation provide that more than one third of the directors may propose the convening of a board meeting.[321] In both limited liability companies and companies limited by shares, all of the directors must be notified of the meeting ten days in advance.[322] However, where the board of directors in a company limited by shares convenes an interim meeting, the manner and time limit of notice may be determined differently by the company.[323]

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313. *Id.* arts. 47 and 115.
314. *Id.*
315. EJV Implementation, *supra* note 17, art. 34.
316. Company Law, *supra* note 1, arts. 45 and 113.
317. *Id.* art. 51.
318. *Id.* art. 114.
319. *Id.* art. 116.
320. EJV Implementation, *supra* note 17, art. 35.
321. Company Law, *supra* note 1, art. 48; EJV Implementation, *supra* note 17, art. 35.
322. Company Law, *supra* note 1, arts. 49 and 116.
323. *Id.* art. 116.

For a company limited by shares, a one half quorum of the directors is required for the convening of a board meeting, and a simple majority of the directors is needed to pass a resolution.[324] The Company Law, on the other hand, is silent on this issue, and it can be interpreted that the articles of association of a limited liability company may specify the details on this matter. However, for a limited liability company with foreign investment, it is very important to note the different rules in the EJV Implementation. The EJV Implementation provides that a two-thirds quorum of directors is required to convene a board meeting.[325] Under the EJV Implementation, while the articles of association may provide the voting procedures for resolutions on other matters, resolutions on the following items must be passed unanimously by the directors present at the board meeting: (1) the amendment of the articles of association of the entity; (2) the termination and dissolution of the entity; (3) the increase or transfer of the registered capital of the entity; and (4) the merger of the entity with other economic organizations.[326]

For both limited liability companies and companies limited by shares, the minutes of the board meeting must be kept and signed by the attending directors.[327] The Company Law imposes more stringent liabilities on the directors in a company limited by shares for the resolutions made by the board of directors. Article 118 of the Company Law stipulates that if a resolution of the board of directors violates the laws, administrative regulations or the company's articles of association, and causes the company to suffer serious losses, the directors participating in the resolution must bear the compensation liability of the company.[328] However, if a director has expressed dissent during the vote, and if the dissent is recorded in the minutes of the meeting, this director may be immune from any liability.[329]

The Company Law also allows a director in a company limited by shares to authorize another director to attend the board meeting on his behalf.[330] The scope of authorization must be defined in the letter of authorization.[331] While the Company Law is silent on this issue for a limited liability company, the EJV Implementation provides rules[332] for an EJV similar to those rules applicable to a company limited by shares under the Company Law.

In both a limited liability company and a company limited by shares, the general manager (or manager) of the company is appointed and dismissed by the board of directors, and may attend the board meeting as an observer without a

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324. *Id.* art. 117.
325. EJV Implementation, *supra* note 17, art. 35.
326. *Id.* art. 36.
327. Company Law, *supra* note 1, arts. 49 and 118.
328. *Id.* art. 118.
329. *Id.*
330. *Id.*
331. *Id.*
332. EJV Implementation, *supra* note 17, art. 35.

voting right.[333] The manager is to be in charge of the day-to-day management of the company, to implement the board of directors' resolutions, and to draft various plans on the company's basic management system.[334] The board of directors of a company limited by shares may decide to appoint a director as the general manager of the company,[335] but this issue will be determined by a provision in the articles of association for a limited liability company. It should be noted that the EJV Law requires that the positions of manger and vice manager in an EJV be split between the foreign venturer and the Chinese venturer.[336] Therefore, a foreign-invested limited liability company has less flexibility in the appointment of manager and vice manager than does a foreign-invested company limited by shares.

C. The Board of Supervisors

1. The Constitution of the Board of Supervisors

The establishment of the board of supervisors is mandatory in a limited liability company only if the company is of large scale in its business operation.[337] A limited liability company with a relatively small number of shareholders and a relatively small business may instead establish one or two supervisors.[338]

In both a limited liability company and a company limited by shares, the board of supervisors must have at least three members, and must designate one member as the meeting convener, and the directors, managers and leading financial personnel are not allowed to serve concurrently as supervisors.[339] The shareholders' representatives and the company employees' representatives constitutes the board of supervisors, the proportion of which may be provided by the company's articles of association.[340]

2. Functions and Authorities of the Board of Supervisors

The board of supervisors in both types of companies acts as an auditing watchdog of the company. Its powers of office include: (1) inspecting the financial affairs of the company; (2) scrutinizing the acts violative of the laws, regulations or articles of association conducted by directors and the general

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333. Company Law, *supra* note 1, arts. 50 and 119.
334. *Id.*
335. *Id.* art. 120.
336. EJV Law, *supra* note 6, art. 6.
337. Company Law, *supra* note 1, art. 52.
338. *Id.*
339. *Id.* arts. 52 and 124.
340. *Id.* Article 52 provides that company employee representatives are elected democratically by the company's employees. *Id.* art. 52. However, there are no provisions governing the manner in which the shareholders' representatives will be determined. Presumably, this may be provided by the company's articles of association.

manager during their performance of official duties; (3) requesting the directors and general managers to correct acts harmful to the interests and benefits of the company; (4) proposing the convening of interim shareholders' meetings; and (5) other functions provided by the company's articles of association.[341] The voting procedures and other rules of procedures of the board of supervisors are provided by the company's articles of association.[342]

D. General Requirements for Directors, Supervisors and Managers

The following discussion in this subsection is common to both limited liability companies and companies limited by shares.

1. Duty of Fidelity, Self Dealing and Conflict of Interests

The Company Law imposes a duty of fidelity on the leading company officers by specifying that company directors, supervisors and the manager must abide by the company's articles of association, and must perform their duties and protect the interests and benefits of the company with loyalty and honesty.[343] They are not permitted to advance any personal interests by exploiting their official positions, or to accept bribes and other illegal gains.[344] Additionally, they are prohibited from divulging the company's secrets.[345]

A director or manager of a company is prohibited from concluding agreements or conducting other transactions on his own behalf or on other people's behalf with his company unless the company's articles of association provide otherwise, or the shareholders' meeting approves otherwise.[346] In addition, directors and managers are not allowed to operate a business which is of the same type as the business of the company on their own behalf or on behalf of other persons.[347] Above all, they are prohibited from engaging in any acts harmful to the interests and benefits of the company, and any profits derived from such acts will be appropriated by the company.[348]

The director and manager of a company are prohibited from embezzling or lending the company's funds to other persons.[349] The assets of the company must not be deposited in a banking account in the name of the director, the manager,

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341. *Id.* arts. 54 and 126.
342. *Id.* arts. 39 and 127.
343. *Id.* arts. 59 and 123.
344. *Id.*
345. *Id.* arts. 62 and 123.
346. *Id.* arts. 61 and 123.
347. *Id.*
348. *Id.*
349. *Id.* arts. 60 and 123.

or others.[350] Directors and managers are also prohibited from providing guarantees with the company assets for the company's shareholders and other persons.[351] If the directors, supervisors, or managers of a company conduct an illegal act and cause damage to the company, they must bear the compensation liability,[352] but the Company Law does not specifically define compensation liability.

2. *Persons Not Allowed to Serve as Directors, Supervisors or Managers*

The Company Law provides that a civil servant, such as a governmental employee, is not allowed to serve as a director, supervisor or manager of a company.[353] The policy consideration underlying this provision may be to minimize governmental interference in the operation of a company and to separate the State from the corporate sector.[354] In addition, the Company Law prohibits a person from serving as a company's director, supervisor or manager if such person has: (1) no capacity or limited capacity for civil actions; (2) been sentenced for corruption or other crimes, where no more than five years have elapsed since the completion of the punishment period; (3) served as the director, manager or factory manager of an insolvent business or enterprise, and he was held personally responsible to its liquidation, where no more than three years have elapsed since the completion of the liquidation; (4) served as the legal representative of an enterprise or company that had its business license revoked, was held personally responsible for the revocation, where no more than three years have elapsed since the revocation; or (5) a relatively large amount of overdue personal debts.[355] Any election or appointment by a company in violation of the above provisions is null and void under the Company Law.[356]

V. COMPARATIVE ADVANTAGES UNDER THE NEW FORMS

The Company Law, in effect since July 1, 1994, provides foreign investors with more opportunities than ever before to directly invest in China. Aside from the previously available forms, namely, the EJV, CJV and WFOE, foreign investors may decide to establish limited liability companies, companies limited by shares, or branches in China. The transnational practitioners should address the following: Which form of foreign direct investment provides the best strategy for a foreign investor with a particular goal? Should one set up a foreign investment enterprise in accordance with China's "old" laws on foreign

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350. *Id.*
351. *Id.*
352. *Id.* art. 63.
353. *Id.* arts. 58 and 123.
354. *See, e.g., BBC Summary of World Broadcasts: State Economic and Trade Commission Vice-Minister on Company Law, supra* note 3 (discussing the general policy reasons underlying the Company Law).
355. Company Law, *supra* note 1, arts. 57 and 123.
356. *Id.*

investment enterprises (EJV Law, CJV Law, or WFOE Law)? Should a foreign investor join one or several Chinese incorporators to form a limited liability company or a company limited by shares? Or, would it be best to establish a branch organization in China? The advantages and disadvantages under one form may well depend upon the characteristics of the foreign investor. Some general conclusions may, nonetheless, be drawn from the legal framework.

A. Advantages Under the Limited Liability Company Format

Article 18 of the Company Law makes it clear that a limited liability company with foreign investment will follow two sets of laws, namely, the Company Law and the Chinese laws on foreign investment enterprises.[357] Furthermore, the Company Law gives the laws on foreign investment enterprises prevailing binding force when there is a conflict between these two sets of laws.[358]

In contrast to the regulations governing companies limited by shares, the Company Law does not limit the domiciles of incorporators of a limited liability company. Thus, a limited liability company may be formed either exclusively by foreign investors or jointly by foreign investors and Chinese partners.[359] For a foreign investor who has already set up an EJV or a WFOE in China, the question is whether to maintain its status quo or to convert the existing entity into a limited liability company in line with the Company Law. For foreign investors who are considering setting up a business presence in China, the question is whether to directly form a limited liability company.

Since a limited liability company must concurrently abide by the Company Law and the existing laws on foreign investment enterprises, the analysis of the advantages of forming a limited liability company should focus on what provisions under the Company Law regarding a limited liability company are new and are not contradictory to the those laws on foreign investment enterprises, and what specific benefits exist under the Company Law over those laws on foreign investment enterprises. From the author's standpoint, the advantage may be twofold.

First, vis-a-vis the EJV format, the use of limited liability company format is conducive to ensuring the autonomy and efficiency of management, and conducive to the standardization of the operation mechanism. The EJV Law and the EJV Implementation, key pieces of legislation governing the EJV in China, were promulgated respectively in 1979 and in 1983.[360] Even though a few articles

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357. *Id.* art. 18.

358. *Id.*

359. *See supra* notes 89-99 and accompanying text (discussing the formation of limited liability companies).

360. *See supra* notes 23-26 and accompanying text (discussing the promulgation of the EJV Law and the EJV Implementation).

have been revised since then, they only provide general, as opposed to specific, rules on the organizational structure and management system of the EJVs.[361] The EJV Law only has one article on this issue (Article 6), and even though the EJV Implementation further elaborates Article 6 in ten articles (Article 33 to Article 42), the legal requirement on the organizational structure is still too general and somewhat ambiguous. In contrast, the Company Law contains twenty-six articles providing a rather detailed and clear picture of the company organizational and managerial system (Article 37 to Article 63), and the forthcoming provisions for the implementation of the Company Law, which are to be promulgated by the State Council, are expected to spell out more detailed rules. The Company Law provides a standard set of rules on the company organizational system consisting of shareholders' meeting, the board of directors, the board of supervisors and the manager, while the general provisions in the EJV Law and EJV Implementation only deal with the board of directors and the manager.[362]

For foreign investors in China, controlling the management of the company and minimizing governmental interference in company operations are critical to economic efficiency. The Company Law provides a sound legal framework in which foreign investors may maneuver their legitimate authority in a limited liability company with foreign investment and may force the Chinese partners to standardize the operating mechanism of the company, while the simplicity of the EJV Law and the EJV Implementation in this regard may mean that the legitimate authority of foreign investors in equity joint venture would be less guaranteed. Moreover, the Company Law provides that the board of directors is only responsible for the shareholders' meeting,[363] and the manager is only responsible to the board of directors.[364] The officials in a company thus have a strong legal basis to be autonomous in the management of the company and to be insulated from interference by governmental authorities.[365] This point is further strengthened by the fact that the Company Law, with the objective of standardizing the company system in China, makes it clear that a company shall autonomously operate its business, and the company shareholders shall have the right to make major decisions and to select managerial personnel.[366]

Second, vis-a-vis the company limited by share format, the formation procedure of a limited liability company is less complicated, thus for foreign investors new to the Chinese market, it is realistic to form a limited liability company before taking further steps. Under the Company Law, the formation of a company limited by shares has to undergo a complicated process, including, inter alia, deciding the formation method, selecting co-promoters, applying to the

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361. *See supra* note 25 and accompanying text (discussing the legislative amendments).
362. EJV Law, *supra* note 6, art. 6; EJV Implementation, *supra* note 17, arts. 33-42.
363. Company Law, *supra* note 1, art. 46.
364. *Id.* art. 50.
365. *See id.* art. 8.
366. *Id.* arts. 4-5.

State-Council authorized department or provincial government for formation approval, applying to the Securities Administration Department of the State Council for share offer approval, concluding consignment sales contracts with stock exchanges for share offers, preparing and disclosing the prospectus, convening the founding meeting, applying for company registration, and so forth.[367] Furthermore, every issue of company shares must be subject to high level governmental approval.[368] In contrast, the formation process of the limited liability company is similar to that of an EJV or a WFOE, which basically includes formulating articles of association with other shareholders, submitting applications to the MOFTEC for approval,[369] and applying for company registration.[370] Therefore, the formation of a limited liability company with foreign investment is more feasible to those foreign investors who lack investing experience in China and do not want to become involved in a complicated process.

The Company Law allows a limited liability company to transform into a company limited by shares subject to approval.[371] Thus a foreign investor may first form a limited liability company, and, if necessary, transform it into a company limited by shares. This flexibility will become more conspicuous and attractive when one takes into account the different capital thresholds for forming a limited liability company and a company limited by shares.[372] In the latter case, the statutory threshold is RMB 10,000,000 yuan,[373] while in the former case, the threshold is substantially lower.[374] The statutory threshold for a limited liability company is flexibly divided into four different categories, ranging from RMB 100,000 yuan for a company engaging in scientific exploration and consultancy to RMB 500,000 yuan for a company engaging in production or commodities wholesaling.[375] Therefore, a foreign investor may start out with a small amount of capital, gain a foothold in, and familiarize itself with the Chinese market and business environment.

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367. *See supra* notes 136-181 and accompanying text (describing the process of formation for companies limited by shares under the Company Law).

368. *See supra* note 153 and accompanying text (discussing share issuance under the Company Law).

369. The Company Law does not specify the examining and approving authority for the establishment of a limited liability company with foreign investment. However, since the limited liability company with foreign investment is required to follow the previous laws on foreign investment enterprises where these laws stipulate otherwise, the formation of the limited liability company with foreign investment, as in the case of an EJV or WFOE, has to apply to the Ministry of Foreign Trade and Economic Co-operation (MOFTEC) for approval.

370. *See supra* notes 89-99 and accompanying text (explaining the formation procedures for limited liability companies).

371. *See supra* notes 184-187 and accompanying text (discussing transformation).

372. *See supra* notes 100-106, 146-148 and accompanying text (describing the capitalization requirements of limited liability companies and companies limited by shares).

373. *Id.*

374. *Id.*

375. *Id.*

It is also worth mentioning that, in contrast to a company limited by shares where more than half of the promoters must have domiciles in China,[376] there is no limitation under the Company Law on the domiciles of shareholders. Thus, a limited liability company may be formed solely by foreign investors.

B. Advantages Under the Company Limited by Shares Format

As noted above, the option of forming a company limited by shares may not be appropriate as the first step for a foreign investor who is new to the Chinese market. However, if the time is ripe, the company limited by shares format may prove suitable to the objectives of a foreign investor.

First, by forming a company limited by shares a foreign investor willing to go public may access more fund-raising channels for the company, both through the Chinese stock market and foreign stock markets. Under the Company Law, the promoters of a company limited by shares may apply the share-offer method and may offer as much as sixty-five percent of the share capital to the public for subscription.[377] In principle, the Company Law also permits the promoters to offer shares in foreign countries subject to the approval by the Securities Administration Department of the State Council.[378] Even more importantly, a company limited by shares with the total amount of RMB 50,000,000 yuan may apply to list its shares in both Chinese stock exchanges and foreign stock exchanges three years after its establishment.[379]

While the drafting of a securities code is still in progress, China has begun its experimentation of issuing and trading stocks based on interim regulations and has so far established the Shanghai Stock Exchange (SHSE) in east China and the Shenzhen Stock Exchange (SZSE) in south China.[380] In 1993, the State Council promulgated the stop-gap Interim Regulations on the Issuance and Trading of Shares (Interim Regulations on Shares) to provide formal nationwide standards for stock transactions in China before a complete securities legislation is adopted by the NPC.[381] The Interim Regulations on Shares provide a legal framework consisting of rules on stock issues and trading, information disclosure, proscribed

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376. *See supra* notes 136-149 and accompanying text (explaining the domicile requirements for companies limited by shares).

377. *See supra* note 152 and accompanying text (discussing share issuance for companies limited by shares).

378. *See supra* notes 160-161 and accompanying text (discussing share offers under the Company Law).

379. *See supra* notes 204-209 and accompanying text (discussing stock exchange listings for companies limited by shares).

380. *See China: Stock Market Takes Fast Track*, CHINA DAILY, May 11, 1994, *available in* LEXIS, Nexis Library, Papers File. SHSE was open in December 1990 and SZSE in July 1991. *Id.* It is reported that despite its short history, the Chinese stock market has been successful. *Id.* At the end of 1991, there were only 14 listed companies in the two stock exchanges. *Id.* The number grew to 52 at the end of 1992, and reached 182 by the end of 1993. By the end of March 1994, 244 companies were listed. *Id.* New issues raised for 1991 hit 644m yuan ($74m); 7.15bn yuan ($822m) in 1992, and 29.48bn ($3.4bn) in 1993. *Id.*

381. *See* Potter, *PRC State Council Issues National Stock Regulations*, *supra* note 154.

conduct, and specify that the State Council Securities Policy Committee (SCSPC) has overall charge of administration of the national stock market, and that the China Securities Regulatory Commission (CSRC) is SCSPC's executive arm responsible for supervision and regulation.[382] In another development with regard to accessing international markets, CSRC signed a memorandum of regulatory cooperation with the Hong Kong securities authorities in June 1993 to ensure effective cross-border regulations of Chinese shares listed on the Hong Kong Stock Exchange (HKSE),[383] and signed the Memorandum of Understanding (MOU) with the U.S. Securities and Exchange Commission (SEC) in April 1994 to pave the way for the listing of Chinese companies on the New York Stock Exchange (NYSE).[384] So far, seven Chinese companies have been listed on the HKSE and three on the NYSE, and another twenty-two companies have been selected to be listed on the HKSE and NYSE before the end of 1994 as the second batch of overseas listings of Chinese companies.[385] Indeed, both because of the fledgling securities regulatory system and the promising prospective of raising funds from foreign stock markets, to form a company limited by shares seems alluring to foreign direct investors. It should also be noted that a company limited by shares has one more fundraising channel: the issuance of company bonds, including convertible bonds which can be converted to shares.[386]

Second, as compared with the format of an EJV, the company limited by shares format may be more conducive to a foreign investor's majority control of the company and the control of major decision-making. In an EJV, the venturers generally negotiate the allocation of the board seats, and the EJV Law requires that the chairman position and vice chairman position be split between the parties.[387] Thus, a foreign venturer with a larger capital contribution (i.e., more than fifty-one percent) would not necessarily hold the chairman position. And technically, even if the capital contribution of the foreign investor accounts for

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382. *Id.*

383. *See* Renee Lai, *New Law Fails on Overseas Listings*, S. CHINA MORNING POST, Mar. 18, 1994 (Business), at 5, *available in* LEXIS, News Library, Papers File.

384. *Accord Paves Way for NYSE Listings*, S. CHINA MORNING POST, Apr. 29, 1994 (Business), at 1, *available in* LEXIS, News Library, Papers File. The MOU will provide a regulatory framework governing the listing of Chinese enterprises and protect investors' interests in trading in those companies in the U.S.. *Id.*

385. *See. id.* The three Chinese companies directly listed on the NYSE are either Chinese-foreign joint ventures, or overseas-incorporated companies. *Id.* Among twenty-two companies planned to list abroad, five will be listed on the NYSE, of which all are State-owned entities. *Id.* Another seventeen companies will be listed on the HKSE. *Id.* It was also reported that stock exchanges in London, Luxembourg, Australia, Vancouver and Singapore have already launched aggressive campaigns for a slice of the market. *Id. See also* Renee Lai & Foo Choy Peng, *London Joins Battle for Listings*, S. CHINA MORNING POST, June 2, 1994 (Business), at 1, *available in* LEXIS, News Library, Papers File. The first nine Chinese companies listed on the HKSE have raised HK$11.3bn up to June 1994, and it is expected that the second twenty-two listed companies will be able to generate US$6 bn from floatation on the HKSE and NYSE. *See* Peng & Chan, *"Mr. China Stock" Cuts A Different Image at Home*, S. CHINA MORNING POST, June 2, 1994 (Business), at 5, *available in* LEXIS, News Library, Papers File.

386. *See supra* notes 218-235 and accompanying text (discussing the issuance of company bonds).

387. EJV Law, *supra* note 6, art. 6.

ninety-nine percent of the total capital and the Chinese party only one percent, the Chinese party must at least be appointed as the vice chairman. The EJV Law also provides the same requirement for the positions of manager and deputy manager.[388] In contrast, the board of directors in a company limited by shares is elected by majority vote of the shareholders,[389] the chairman and vice chairman are elected by majority vote of the directors,[390] and the manager is appointed by the board of directors.[391] Therefore, a fifty-one percent shareholder would have total control over the composition of the board. From a control perspective, the company-limited-by-shares setup amplifies the power of the majority shareholder over the company, and the equity-joint-venture format tends to provide the party with smaller investment more protection.[392]

The EJV Implementation requires that major issues must be decided by unanimous vote of the board of directors.[393] Therefore, a deadlock may arise only if one director disagrees with a resolution. This problem would not, however, exist in a company limited by shares. Under the Company Law, the vote by more than half of the directors present at the meeting will pass any resolution discussed at the board meeting.[394] Therefore, a group of shareholders representing a small percentage of interest in a company limited by shares would not be able to block an action.[395]

C. Advantages Under the Branch Format

The provisions regarding the establishment of branches of foreign companies in China are rather general and in the early stages of legislative development. Although detailed administrative regulations are still to be promulgated by the State Council, forming a branch and directly conducting business in China has indeed become a realistic alternative for foreign investors. The author expects that the Chinese government will still impose more restrictions on branches of foreign companies than western countries do, but at least under the Company Law, a liberal breakthrough has been made in that branches of foreign companies are allowed to engage in direct manufacturing, sales of goods and after-sales services in China.[396]

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388. *Id.*
389. Company Law, *supra* note 1, art. 92.
390. *Id.* art. 113.
391. *Id.* art. 119.
392. *See* Matthew D. Bersani, *Stock Companies in China: An Alternative Format for Foreign Investment?* 15 E. ASIA EXEC. REP., 7, 9 (1993). Mr. Bersani's analysis is based on the regulatory opinions concerning companies limited by shares before the Company Law was enacted. *Id.*
393. EJV Implementation, *supra* note 17, art. 36.
394. Company Law, *supra* note 1, art. 117.
395. *See* Bersani, *supra* note 392.
396. *See supra* notes 256-266 and accompanying text (discussing the permissable operations for branches of foreign companies in China).

First, the advantage under the branch format has to do with the ease of establishment. The establishment of an EJV, a limited liability company or a company limited by shares is a multi-step, and sometimes time-consuming process involving negotiations and various governmental scrutinies. When a foreign investor is unsure about the Chinese market but is afraid of losing competitiveness if delaying its business presence in China, a branch may work as a sounding board before the investor has an active and large-scale presence in China. The Company Law provides a rather flexible principle with regard to the capital of a branch organization by requiring that the foreign parent company allocate to the branch an amount of capital compatible to the branch's operations.[397] Therefore, the foreign investor may increase or decrease the capital of the branch depending on the profitability of the branch and the perspective of the market.

Second, it is advantageous to set up a branch in China so far as operational flexibility is concerned. The foreign parent may, depending on the market situations, change the branch into a wholly-owned subsidiary, or find a Chinese partner and turn it into an EJV or a limited liability company. In addition, the foreign investor may also participate in the promotion of a company limited by shares through the effort of the branch.

Third, in terms of long-term strategic planning, the branch format may better protect the investment from nationalization and expropriation by the Chinese government. Both the EJV Law and the WFOE Law provide that the State shall not nationalize or expropriate the foreign investment, but meanwhile provide that the State may do so under special situations, providing compatible compensations.[398] Although nationalization and expropriation is very improbable given the fact that the Chinese government is strongly committed to a persistent opening-up policy and the fact that China is becoming more and more interdependent with the rest of the world, such governmental action based on State sovereignty is by no means out of the question. Under the Company Law, however, the prescribed legal status of the branch of a foreign company may provide one more layer of protection for the branch.[399] Under the Company Law, as mentioned above, the branches of foreign companies do not have Chinese legal-person status, and consequently the foreign parent company must bear all the liabilities incurred by the branch.[400] The assets of the branches are thus

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397. Company Law, *supra* note 1, art. 201.

398. EJV Law, *supra* note 6, art. 2; WFOE Law, *supra* note 22, art. 5.

399. It should be noted that the author's point is that the legal and diplomatic protection for the branch of a foreign company against nationalization is stronger than for those foreign investment enterprises having Chinese-legal-person status. The author does not mean that by establishing a branch, nationalization is out of the question. Indeed, because of the foreign identity of the branch, the Chinese government would have more diplomatic concerns.

400. *See supra* notes 240-242 and accompanying text (discussing the status of branches of foreign companies under the Company Law).

regarded, at least as a matter of law, as being directly owned by foreign companies. And since the branch is not a Chinese legal person, the legislative jurisdiction of the Chinese government might not reach the branch as far as it does the wholly foreign-owned subsidiary in China. Indeed, if the branch were regarded as a Chinese legal person, it would be more vulnerable to possible governmental actions within the Chinese jurisdiction. With the identity as an extension of a foreign company, the government of the foreign company's country may have a sound juridical reason to claim diplomatic protection over the branch and its assets when expropriation became imminent in China.

This strategic planning would, for two reasons, appear particularly important to foreign-funded financial institutions in China. First, Chinese law requires foreign banks to place a non-interest-bearing deposit reserve with the People's Bank of China (PBOC), the Chinese central bank, with the ratio decided by the PBOC.[401] In the case of a imminent nationalization, though this reserved asset is physically under the Chinese governmental control, the fact that this asset is owned by a foreign legal person provides a strong legal basis for diplomatic protection by the government of the foreign bank. Second, the financial assets controlled by the banking branches have unique features in that they can be easily transferred through the modern banking communication system. If a nationalization order is pending, the branches may transfer their controllable assets according to the instruction of the foreign headquarter, which, by theory can freely move its controllable assets within the group. However, if the foreign-funded financial institutions in China had Chinese legal-person status, the Chinese government would be in a better position to enforce its sovereign rights on these institutions because of their nationalities.

The Chinese banking system has become more liberalized than ever since 1949, and foreign banking corporations have been flocking to Chinese banking markets since 1990.[402] In March 1994, the Chinese State Council issued new rules for foreign banks and financial institutions titled Regulations Governing Foreign Financial Institutions in China, which sets out the scope and limits of the operations of five categories of ventures, namely, foreign-owned banks with head offices in China, branches of foreign banks, Chinese-foreign joint-venture banks,

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401. *See generally* MU & GUIGUO, *supra* note 7 (discussing the content of the Regulations Governing Foreign Financial Institutions in China).

402. *See* Kennis Chu, *Nanyang Set for Growth in China*, S. CHINA MORNING POST, Jan. 30, 1994 (Sunday Ed.), at 2, *available in* LEXIS, News Library, Papers File. For example, Nanyang Commercial Bank, a Hong Kong based bank, has opened fives branches in Shenzhen, Shekou, Haikou, Guangzhou and Dalian up to January 1994. *Id.* It also has a joint-venture bank in Ningbo with Zhejian Commercial Bank, Zhejiang's Bank of China, Ningbo's Bank of Communication and Zhejiang's International Trust and Investment Bank. *Id.* Its China operation, sharing fifteen percent of the bank's total business, operates mortgages, project financing and trade financing. *Id. See also China HQ for CITIBANK*, S. CHINA MORNING POST, Aug. 19, 1993 (News), at 1, *available in* LEXIS, News Library, Papers File. As a more liberal step, China, in August 1993, allowed CITIBANK to open its Chinese headquarters in Shanghai. *Id.* CITIBANK has established two branches and three representative offices in China up to August 1993, and it is planning to build up a branch nextwork in Chinese coastal areas. *Id.*

foreign-owned finance companies, and Chinese-foreign joint-venture finance companies, and spells out application procedures and requirements for a license to operate a banking or financial business in China.[403] With more forms and opportunities available for the banking business presence in China, transnational practitioners not only need to carefully read the Chinese laws and regulations in the banking area between the lines, but need to keep in mind that the aforesaid strategy should have a bearing on the overall business structure of foreign investors.

VI. CONCLUSION

As the first Chinese national company-law legislation since 1949, the Company Law, indeed, needs fine-tuning because a more specific set of administrative supplementary regulations for implementation is still to be seen. Nevertheless, the Company Law is a major and fairly comprehensive piece of legislation in China, providing a solid legal basis for future development in the company law area and representing a big step in the right direction to put China on the international corporate map.[404] Moreover, the Company Law allows companies in China to function in a standardized way without much bureaucratic interference from the

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403. *See* Foo Choy Peng et al., *China Sets New Rules for Banks*, S. CHINA MORNING POST, Mar. 2, 1994 (Business), at 1, *available in* LEXIS, News Library, Papers File. Having become effective April 1, 1994, these Regulations also apply to financial concerns set up by Hong Kong, Macau and Taiwan companies. *Id.* The role of China's central bank, the People's Bank of China (PBOC), will be vested with final authority to interpret these Regulations. *Id.* The Regulations provide conditions under which foreign financial institutions can operate Renminbi yuan business, which was previously off limits to foreign financial institutions in China. *Id.* Other key rules of these Regulations include, among others: foreign applicants must have a total asset base of not less than US$20 billion a year before applying for a license; they must come from a country whose financial regulatory and governing framework is sound, and will have to submit annual reports for the past three financial years; branches of foreign banks and joint-venture banks would need a minimum capital requirement of RMB 300 yuan, while for Chinese-foreign financial joint ventures it is RMB 200 million yuan; the PBOC will decide lending and saving rates, and the level of service charges by foreign banks; foreign banks are required to place a non-interest-bearing deposit reserve with respective PBOC's regional offices, the ratio set by the PBOC; thirty percent of foreign banks' working capital has to be kept in assets as set by the PBOC and includes placing deposits at designated banks; total assets of foreign operations including joint ventures cannot exceed twenty times the sum of its paid-up capital and reserves; total deposits attracted inside China cannot exceed forty per cent of total assets; at least one Chinese citizen must be employed in senior management; and, foreign operations are required to employ China-certified accountants, approved by regional PBOC offices. *Id. See also China HQ for CITIBANK*, S. CHINA MORNING POST, Aug. 19, 1993 (News), at 1, *available in* LEXIS, News Library, Papers File. Originally, foreign financial institutions were only allowed to set up branches, financial joint-ventures and finance houses in Shanghai and the five special economic zones (SEZs), which include Shenzhen, Hainan, Xiamen, Santou, and Zhuhai. *Id.* In 1992, China opened up seven more cities for foreign branches but the banking operations were only guided by financial regulations designed for the SEZs in 1985, and another designed for Shanghai in 1990. *Id.* China's intention to open up more cities to foreign banks was evident in one of the clauses of the Regulations, which allows the PBOC to decide the locations where foreign-funded financial institutions may set up. *Id. See* Foo Choy Peng, *New Rules Give Clearer Picture to Foreign Firms*, S. CHINA MORNING POST, Apr. 1, 1994 (Business), at 4, *available in* LEXIS, News Library, Papers File.

404. *See* Ho, *supra* note 2, at 9.

Chinese government, which has long been one of the obstacles for investing in China. In fact, with the nurturing of the concept of shareholder's ownership (in contrast to State ownership) and the development of a company system (in contrast to the State enterprise system), the overall business environment in China, not just the legal environment, will be more conducive to the growth of foreign investment in China so far as a market-oriented business culture is concerned.

By allowing foreign investors to participate in the formation of limited liability companies and companies limited by shares, and to establish branches directly transacting business in China, the Company Law offers new direct investment vehicles in addition to EJVs, CJVs and WFOEs. Indeed, by specifying the basis of formation, organizational structures, operational requirements and various rights and liabilities for companies, the Company Law allows transnational practitioners to analyze the legal risks and comparative advantages under different formats of direct foreign investment in China based on more concrete legal norms.

APPENDIX

COMPANY LAW OF THE PEOPLE'S REPUBLIC OF CHINA

(Passed at the Fifth Session of the Standing Committee of the Eighth National People's Congress.)

The Presidential Order of the People's Republic of China, No.16:

The Company Law of the People's Republic of China has been passed on December 29, 1993, at the Fifth Session of the Standing Committee of the Eighth National People's Congress of the People's Republic of China. It is now published, and shall go into effect July 1, 1994.

Jiang Zeming
President of the People's Republic of China
December 29, 1993

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CHAPTER I: GENERAL PRINCIPLES

Article 1: This Law is formulated in accordance with the Constitution to meet the needs of establishing a modern enterprise system, to standardize the organization and activities of companies, to protect the legitimate rights and interests of companies, shareholders and creditors, to safeguard social and economic order, and to facilitate the development of a socialist market economy.

Article 2: For the purpose of this Company Law, the term "company" refers either to a limited liability company or to a company limited by shares established within the territory of China in accordance with this Law.

Article 3: Both limited liability companies and companies limited by shares are enterprise legal persons.

In the case of a limited liability company, a shareholder is liable to the company to the extent of the shareholder's capital contribution. A limited liability company is liable for the debts of the company to the extent of all its assets.

In the case of a company limited by shares, its entire capital is divided into shares of equal value and shareholders shall be liable to the company to the extent of the shares held by them. A company limited by shares is liable for the debts of the company with all its assets.

Article 4: As a capital contributor, a shareholder of a company shall, in accordance with the amount of his capital invested in the company, be entitled to enjoy the owner's rights such as enjoying benefits from the company's assets, making major decisions, and choosing the managerial personnel.

A company shall enjoy all the legal person's property rights constituted by its shareholders' investments, and enjoy the civil rights and assume civil liabilities in accordance with the law.

State-owned assets in a company shall belong to the State.

Article 5: Within the limits of the property it controls as a legal person, a company shall autonomously conduct its business operations and be responsible for its own profits and losses.

A company shall, under macro-control of the State, autonomously organize its production and operations in accordance with the market demand in order to promote economic efficiency and labor productivity and to preserve and increase the value of its assets.

Article 6: A company shall implement an internal management system with a clear delineation of rights and responsibilities, a scientific management, and a combination of incentives and restrictions.

Article 7: When a State-owned enterprise is reorganized into a company, it must, according to the conditions and requirements stipulated in the laws and administrative regulations, transform its operational system, systematically ascertain its assets, and verify its capital, define its property rights, clear claims and indebtedness, evaluate its assets, and establish a standardized internal management mechanism.

Article 8: The establishment of a limited liability company or a company limited by shares must comply with the conditions set out in this Law. A company meeting the conditions of this Law can be registered as a limited liability company or a company limited by shares; a company not meeting the conditions of this Law shall not be registered.

Where the laws or administrative regulations require that the establishment of a company be subject to examination and approval, the procedures for such examination and approval shall be carried out in accordance with the laws and regulations prior to the registration of the company.

Article 9: The company name of a limited liability company established in accordance with this Law must contain the words "limited liability company."

The company name of a company limited by shares established in accordance with this Law must contain the words "company limited by shares."

Article 10: The domicile of a company shall be where its principal place of business is located.

Article 11: In establishing a company, the company's articles of association must be formulated in accordance with this Law. The articles of association shall be binding on the company, its shareholders, directors, supervisors, and managers.

The business scope of a company shall be specified in the articles of association and registered in accordance with the law. With regard to those items in a company's business scope which are restricted by laws and administrative regulations, approvals shall be obtained in accordance with the laws.

A company shall conduct its business activities within its registered business scope. A company may change its business scope by amending its articles of association in accordance with legal procedures and after modifying its registration with the company registration authority.

Article 12: A company may invest in other limited liability companies or companies limited by shares and shall assume its liabilities to the companies in which it has invested to the extent of the amount of the invested capital.

With the exception of investment companies and holding companies specified by the State Council, where a company invests in other limited liability companies or companies limited by shares, the aggregate amount of investment shall not exceed fifty percent of the net capital and assets of the investing company, exclusive of any increase of its capital in the invested companies converted from the profit of these companies.

Article 13: A company may set up branches. Branches of a company shall not have the status of an enterprise legal person and the company shall assume the civil liabilities of its branches.

A company may set up subsidiaries. Subsidiaries of a company shall have the status of an enterprise legal person and shall independently assume civil liabilities in accordance with the laws.

Article 14: A company must in conducting its business operations abide by the laws, follow professional ethics, strengthen the development of the socialist civilization, and accept the supervision of the government and the public.

The legitimate rights and interests of a company are protected by the law and shall not be infringed upon.

Article 15: A company must protect the legitimate rights and interests of its employees, strengthen labor protection, and achieve safety in production.

A company shall, through various means, stress vocational education and on-the-job training for its employees and increase the skills and knowledge of its employees.

Article 16: The employees of a company may, in accordance with the law, organize a trade union to carry on union activities and protect the lawful rights

and interests of the employees. A company shall provide the conditions necessary for the activities of the trade union.

A wholly State-owned company, and a limited liability company established by two or more State-owned enterprises, or by two or more other State-owned investment entities shall, in accordance with the provisions of the Constitution and provisions of the relevant laws, carry out democratic management through the meetings of employees' representatives and otherwise.

Article 17: The activities of the basic-level organizations of the Chinese Communist Party in a company shall be conducted in accordance with the Charter of the Chinese Communist Party.

Article 18: This Company Law shall also apply to a limited liability company with foreign investment. Where the relevant laws on Chinese-foreign equity joint-venture enterprises, Chinese-foreign cooperative joint-venture enterprises and wholly-owned foreign enterprises provide otherwise, the provisions of such laws shall prevail.

CHAPTER II: FORMATION AND ORGANIZATIONAL STRUCTURE OF LIMITED LIABILITY COMPANY

Section I: Formation

Article 19: To form a limited liability company, the following conditions shall be met:

(1) the number of shareholders satisfies the statutory number;
(2) the capital contribution of shareholders attains the statutory minimum amount;
(3) the shareholders jointly formulate the company's articles of association;
(4) the entity has a company name, and has established an organizational structure consistent with the requirements for a limited liability company; and
(5) the entity possesses fixed sites for production and operation, and meets other necessary conditions for production and operation.

Article 20: A limited liability company shall be formed by means of a joint capital contribution by at least two but no more that fifty shareholders.

A State-authorized investment entity or department authorized by the State may, through its exclusive investment, form a State wholly-owned limited liability company.

Article 21: A State-owned enterprise established before this Law goes into effect may be reorganized into a State wholly-owned limited liability company if it meets the conditions for establishing a limited liability company as provided in

this Law and if it has an exclusive investor; where there is more than one investor, it may be reorganized into a limited liability company as provided in paragraph one of the preceding Article.

The State Council shall separately stipulate implementing procedures and detailed measures concerning the reorganization of a State-owned enterprise into a company.

Article 22: The articles of association of a limited liability company shall provide the following items:

(1) name and domicile of the company;
(2) business scope of the company;
(3) registered capital of the company;
(4) names of shareholders;
(5) rights and obligations of shareholders;
(6) methods and amounts of capital contribution by shareholders;
(7) conditions for the transfer of capital by shareholders;
(8) organs of the company, and their procedures for establishment, their functions and authorities, and rules of procedure;
(9) legal representative of the company;
(10) basis for dissolution of the company and liquidation procedures; and
(11) other matters as deemed necessary by the shareholders.

Shareholders shall sign and attach their seals to the company's articles of association.

Article 23: The registered capital of a limited liability company shall be the amount of capital actually paid in by all of the shareholders and registered with the company registration authority.

The registered capital of a limited liability company shall not be less than the following amounts:

(1) RMB 500,000 yuan for a company engaging in production operations as its principal business;
(2) RMB 500,000 yuan for a company engaging in wholesaling of commodities as its principal business;
(3) RMB 300,000 yuan for a company engaging in commercial retailing as its principal business; or
(4) RMB 100,000 yuan for a company engaging in scientific and technological development, consultation, and service.

Where the minimum amount of the registered capital of a limited liability company in a special industry needs to exceed the minimum amount as specified in the preceding paragraph, it shall be separately specified by laws and administrative regulations.

Article 24: A shareholder may contribute capital by means of currency or by capitalization of intangible property, industrial property rights, non-patented technology or land use rights. The invested tangible property, industrial property rights, non-patented technology, or land use rights must be evaluated and verified. Neither over-evaluation nor under-evaluation shall be permitted. The evaluation of the price for land use rights shall be carried out in accordance with the laws and administrative regulations.

The amount of capital contributed by means of the capitalization of industrial property rights and non-patented rights shall not exceed twenty percent of the registered capital of a limited liability company, except where there are special State regulations concerning the application of high and new technological developments.

Article 25: A shareholder shall fully pay in the subscribed contribution provided in the company's articles of association. Where a shareholder pays his capital contribution in currency, the full payment of the contribution in currency shall be deposited into a temporary account opened in a bank by the proposed limited liability company; where a shareholder uses tangible property, industrial property rights, non-patented technologies, or land-use rights to make capital contributions, the procedures for the transfer of property rights shall be carried out according to the law.

A shareholder who fails to make his capital contribution in accordance with the preceding paragraph shall bear the liability for breach of contract toward other shareholders who have made their capital contribution in full.

Article 26: After all shareholders have made their capital contributions in full, the capital must be verified by a legal capital-verification organization, and a capital-verification certificate shall be issued.

Article 27: After all of the capital contribution of shareholders have been verified by a legal capital-verification organization, a representative appointed by all of the shareholders or an agent jointly authorized by all of the shareholders shall make an application to the company registration authority to register its establishment and shall submit documents such as the company registration application, the company's articles of association, and a capital-verification certificate.

Where the provisions of laws and administrative regulations require that the establishment of a company be subject to examination and approval by relevant

authorities, documents of such approval shall also be submitted when applying for the establishment registration.

The company registration authority shall register and issue a company business license to a company meeting the conditions provided in this Law, and it shall not register a company not meeting the conditions provided in this Law.

The issuing date of the company business license shall be the date of the establishment of the company.

Article 28: After a limited liability company has been set up, if it is found that the actual value of the contributed tangible property, industrial property rights, non-patented technology or land-use rights is markedly lower than the value specified by the company's articles of association, those shareholders making these capital contributions shall make up the difference, and the other shareholders existing at the time of the company's establishment shall bear joint and several liability with those shareholders.

Article 29: If a branch is formed at the same time as the limited liability company, a registration application shall be made to the company registration authority concerning the formation of the branch, and a business license therefor shall be obtained.

If a branch is formed after the limited liability company has been established, the legal representative of the company shall apply to the company registration authority for registration and the issuance of a business license.

Article 30: After a limited liability company has been established, capital contribution certificates shall be issued to the shareholders.

A capital contribution certificate shall include the following items:

(1) the company's name;
(2) the registration date of the company;
(3) the company's registered capital;
(4) the shareholder's name, the amount of his paid-in capital contribution and the date of such capital contribution; and
(5) the serial number and issuing date of the capital contribution certificate.

The company shall affix its official seal to the capital contribution certificate.

Article 31: A company shall keep a shareholders' register to record the following items:

(1) name and domicile of each shareholder;
(2) amount of capital contribution of the shareholder; and
(3) serial number of the capital contribution certificate.

Article 32: A shareholder shall be entitled to inspect the minutes of the Shareholders' Meeting and the financial accounting reports of the company.

Article 33: A shareholder's dividend shall be proportionate to his capital contribution. When a company increases its capital, its shareholders shall have the priority right to subscribe to new shares.

Article 34: A shareholder shall not be permitted to withdraw his capital contribution after the company has been registered.

Article 35: Shareholders may transfer among themselves their total or partial capital contributions.

When a shareholder transfers his contributed capital to parties other than shareholders, approval by a simple majority of shareholders shall be required; a shareholder disagreeing with the transfer may purchase the said capital. If such shareholder does not purchase the said capital, the transfer shall be deemed approved.

For capital which shareholders have agreed to transfer, other shareholders shall, under the same conditions, have priority right to purchase the said capital.

Article 36: After a shareholder has transferred his capital in accordance with the law, the company shall record in its shareholders' register the transferee's name, domicile, and the amount of transferred capital.

Section II: Organizational Structure

Article 37: The Shareholders' Meeting of a limited liability company shall include all of the shareholders; it shall be an organ of authority and exercise its functions and authorities in accordance with this Law.

Article 38: The Shareholders' Meeting shall exercise the following functions and authorities:

(1) to determine the company's operational principles and investment plans;

(2) to elect and remove directors, and decide matters regarding the remunerations of directors;

(3) to elect and remove supervisors who are representatives of shareholders, and decide matters regarding the remuneration of supervisors;

(4) to examine, discuss, and approve the reports of the Board of Directors;

(5) to examine, discuss, and approve the reports of the Board of Supervisors or of a supervisor;

(6) to examine, discuss, and approve the company's annual plans for financial budgets and final accounts;

(7) to examine, discuss, and approve the company's profit distribution plans and loss-recovery plans;
(8) to adopt resolutions on the increase or reduction of the company's registered capital;
(9) to adopt resolutions on the issuance of company bonds;
(10) to adopt resolutions on the transfer of capital from a shareholder to parties other than shareholders;
(11) to adopt resolutions on matters such as company merger, separation, transformation, and dissolution and liquidation; and
(12) to adopt amendment to the articles of association of the company.

Article 39: Except as otherwise provided in this Law, the convening method and voting procedure of the Shareholders' Meeting shall be stipulated in the articles of association of the company.

When the Board of Directors adopts its resolutions regarding the increase or reduction of the company's registered capital, or its division, merger, dissolution or transformation, these resolutions must be passed by a two-thirds majority of the voting rights of shareholders.

Article 40: A company may amend its articles of association. A resolution on amendment of the company's articles of association must be passed by a two-thirds majority of the voting rights of shareholders.

Article 41: A shareholder shall exercise his voting right at the Shareholders' Meeting according to the proportion of his capital contribution.

Article 42: The first Shareholders' Meeting shall be called and presided over by the shareholder with the largest capital contribution, and shall exercise its functions and authorities according to this Law.

Article 43: The Shareholders' Meeting shall consist of regular and interim meetings.

Regular meetings shall be convened in a timely manner pursuant to the provisions of the company's articles of association. Either shareholders representing one-fourth of the voting rights or one-third of the directors or of the supervisors may propose the convening of an interim meeting.

Where a limited liability company establishes the Board of Directors, the Shareholders' Meeting shall be called by the Board of Directors and shall be presided over by the chairman of the Board of Directors. If the chairman of the Board of Directors is unable to perform his functions and duties because of special reasons, the chairman may appoint a vice chairman of the Board of Directors or another director to preside over the meeting.

Article 44: A company shall notify all of its shareholders fifteen days prior to the convening of the Shareholders' Meeting.

The Shareholders' Meeting shall draw up minutes of meetings regarding the resolution of discussed matters; shareholders attending the meeting shall sign the minutes of meetings.

Article 45: A limited liability company may establish a Board of Directors of three to thirteen members.

Members of the Board of Directors of a limited liability company established by two or more State-owned enterprises or by two or more State-owned investment entities shall include representatives from the company's employees. The employee representatives to the Board of Directors shall be elected by the employees of the company.

The Board of Directors shall have one chairman and may have one or two vice chairmen. The methods for selecting the chairman and vice chairmen shall be provided in the company's articles of association.

The chairman of the Board of Directors shall be the company's legal representative.

Article 46: The Board of Directors shall be responsible to the Shareholders' Meeting and shall exercise the following functions and authorities:

(1) to be responsible for calling the Shareholders' Meeting and to report the Board's work to the Shareholders' Meeting;
(2) to implement resolutions of the Shareholders' Meeting;
(3) to determine the company's operational and investment plans;
(4) to formulate the company's annual plans of financial budgets and final accounts;
(5) to formulate the company's profit distribution plans and loss recovery plans;
(6) to formulate plans for increasing or reducing the company's registered capital;
(7) to draft plans for merger, separation, transformation, or dissolution of the company;
(8) to determine the constitution of the company's internal managerial divisions;
(9) to appoint or dismiss the company's manager (or general manager, hereinafter referred to as the manager); and, based on the manager's nomination, appoint or dismiss the company's deputy manager and leading financial personnel, and decide matters regarding their remunerations; and
(10) to formulate the company's fundamental management system.

Article 47: The term of office of a director shall be specified in the company's articles of association, but no term shall exceed three years. A director may, after his term has expired, continue to serve additional consecutive terms if re-elected.

The Shareholders' Meeting shall not, before the term of office of a director has expired, remove the director from his position without justification.

Article 48: Meetings of the Board of Directors shall be called and presided over by the chairman of the Board of Directors; if the chairman is unable to perform his functions and duties because of special reasons, the chairman may appoint a vice chairman or another director to call and preside over meetings. One-third or more of the directors may propose to convene a meeting of the Board of Directors.

Article 49: Except as otherwise provided in this Law, the manner of convening and the voting procedure for the Board of Directors shall be provided in the company's articles of association.

A company shall notify its directors ten days before the convening of a meeting of the Board of Directors.

The Board of Directors shall draw up minutes of meetings regarding the resolutions on discussed matters; directors attending the meetings shall sign the minutes of meetings.

Article 50: A limited liability company shall have one manager who shall be appointed or dismissed by the Board of Directors. The manager shall be responsible to the Board of Directors and exercise the following functions and authorities:

(1) to be in charge of the management of production and operation of the company, and to implement resolutions of the Board of Directors;
(2) to implement the company's annual operational and investment plans;
(3) to draft plans for the constitution of the company's internal managerial divisions;
(4) to draft the company's fundamental management system;
(5) to formulate the detailed rules and regulations of the company;
(6) to propose the appointment or dismissal of the company's deputy manager and leading financial personnel;
(7) to appoint or dismiss the managerial personnel other than those appointed or dismissed by the Board of Directors; and
(8) to carry out other functions as assigned in the company's articles of association and by the Board of Directors.

The manager may attend meetings of the Board of Directors as an observer.

Article 51: A limited liability company with a relatively small number of shareholders and operating on a relatively small scale may have one executive director without establishing a Board of Directors. The executive director may concurrently hold the position of company manager.

The functions and authorities of an executive director shall, with reference to the provisions of Article 46 of this Law, be provided in the company's articles of association.

Where a limited liability company does not establish a Board of Directors, the executive director shall be the company's legal representative.

Article 52: A limited liability company with a relatively large scale of business operation shall establish a board of supervisors consisting of at least three members. The board of supervisors shall choose a convener from its members.

The board of supervisors shall consist of the shareholders' representatives and the company's employee representatives in appropriate proportions; the specific proportions shall be provided in the company's articles of association. The employee representatives on the board of supervisors shall be democratically elected by the company's employees.

A limited liability company with a relatively small number of shareholders and a relatively small scale may have one or two supervisors.

A director, manager or leading financial personnel shall not concurrently hold the position of supervisor.

Article 53: Each term of office of a supervisor shall be three years. After the term of office of a supervisor has expired, the supervisor may continue to serve for additional consecutive terms if re-elected.

Article 54: A Board of Supervisors or a supervisor shall exercise the following functions and authorities:

(1) to inspect the company's financial affairs;
(2) to scrutinize acts of directors and managers which, during the performance of their functions and duties, are in violation of the laws, regulations, or the company's articles of association;
(3) to request directors and managers to rectify their acts if harmful to the interests of the company;
(4) to propose the convening of an interim Shareholders' Meeting; and
(5) to carry out other functions as provided in the company's articles of association.

Supervisors may attend meetings of the board of directors as observers.

Article 55: When studying and deciding matters relating to employees' immediate or vital interests such as employees' wages, welfare, safety in

production, labor protection, and labor insurance, a company shall in advance obtain the opinions of the company's trade union and employees, and invite the trade union or employee representatives to attend relevant meetings as observers.

Article 56: When studying and deciding major issues of production and operation and formulating important rules and regulations, a company shall obtain the opinions and suggestions of the company's trade union and employees.

Article 57: A person shall not hold the position of company director, supervisor, or manager if one of the following situations exists:

(1) the person has restricted or no capacity for civil actions;
(2) the person was sentenced for corruption, bribery, seizure of property, embezzlement of property or disruption of the social and economic order, and less than five years has elapsed since the expiration of his term of punishment; or the person was deprived of his political rights because of his criminal offense, and less than five years has elapsed since he finished serving his prison term;
(3) the person has served as the director, factory head, or manager of a company or enterprise which was declared bankrupt and was liquidated as a result of unsound business operations, and bore personal responsibility for its bankruptcy, and less than three years has elapsed since the completion of bankruptcy liquidation of the company or enterprise;
(4) the person was the legal representative of a company or enterprise which had its business license revoked because of illegal business operations, and bore personal responsibility for its revocation, and less than three years has elapsed since the business license of the company or enterprise was revoked; or
(5) the person bears a relatively large amount of debt that has been due and is still outstanding.

If an election or designation of a director or supervisor, or an appointment of a manager by a company is in violation of the provisions of the preceding paragraph, such election or appointment shall be void.

Article 58: A State public servant shall not concurrently hold the position of company director, supervisor or manager.

Article 59: Directors, supervisors and managers shall abide by the company's articles of association, and shall faithfully and honestly perform their functions and duties and shall not be permitted to use their positions and powers to seek personal gain.

Directors, supervisors and managers shall not be allowed to exploit their functions and authorities to accept bribes or other illegal gain or to seize the company's property.

Article 60: A director or manager shall not be allowed to embezzle the company funds or to lend the company funds to others.

A director or manager shall not be allowed to deposit company assets in accounts in his name or in another person's name.

A director or manager shall not be allowed to use company assets to provide guarantee for personal debts payable by the company's shareholders or other persons.

Article 61: A director or manager shall not be allowed to operate on his own or on behalf of other persons any business which is similar to the business of the company where he is holding his position, or to engage in any activity harmful to the interests of the company. If a director or manager is engaged in any of the aforesaid business operations or activities, the income gained thereby shall become the property of the company.

Except as otherwise provided in the company's articles of association or approved by the Board of Shareholders, a director or manager shall not be allowed to conclude contracts or conduct business with the company where he is holding the position of director or manager.

Article 62: Except as otherwise provided in the law or approved by the Board of Directors, a director, supervisor, or manager shall not be allowed to divulge company secrets.

Article 63: If a director, supervisor, or manager, during the performance of his functions for the company, violates the law and administrative regulations or the provisions of the company's articles of association and thereby cause damages to the company, he shall bear compensation liabilities.

Section III: Wholly State-Owned Companies

Article 64: For the purpose of this Law, a wholly State-owned company refers to a limited liability company established through an exclusive investment by a State-authorized investment entity or State-authorized department.

A company which is designated by the State Council as a company producing special products or belonging to a specified industry shall adopt the form of a wholly State-owned company.

Article 65: The articles of association of a wholly State-owned company shall be formulated by the State-authorized investment entity or by the State-authorized department in accordance with this Law, or shall be formulated by the Board of

Directors and submitted to the State-authorized investment entity or State-authorized department for approval.

Article 66: A wholly State-owned company shall not establish the Shareholders' Meeting, and the State-authorized investment entity or State-authorized department shall authorize the Board of Directors of the company to exercise part of the functions and authorities of the Shareholders' Meeting and to decide major matters of the company. However, matters such as the company's merger, separation, dissolution, increase, or reduction of capital, and issuance of company bonds must be determined by the State-authorized investment entity or State-authorized department.

Article 67: The State-authorized investment entity or the State-authorized department shall, in accordance with the law and administrative regulations, supervise and administrate the State assets of a State wholly-owned company.

Article 68: A wholly State-owned company shall establish a Board of Directors to exercise functions and authorities in accordance with the provisions of Articles 46 and 66 of this Company Law. The term of office for each Board of Directors shall be three years.

The Board of Directors of a company shall consist of three to nine members who shall be appointed or removed by the State-authorized investment entity or the State-authorized department in accordance with the term of office for the Board of Directors. Among the members of the Board of Directors there shall be representatives of the company's employees. The employee representatives on the Board of Directors shall be democratically elected by the company's employees.

The Board of Directors shall have one chairman and may, as necessary, have vice-chairmen. The chairman and vice-chairmen shall be selected by the State-authorized investment entity or the State-authorized department from the members of the Board of Directors.

The chairman of the Board of Directors shall be the company's legal representative.

Article 69: A wholly State-owned company shall have a manager whose appointment and dismissal shall be determined by the Board of Directors. The manager shall exercise his functions and authorities in accordance with the provisions of Article 50 of this Law.

Subject to approval by the State-authorized investment entity or State-authorized department, a member of the Board of Directors may concurrently hold the position of manager.

Article 70: The chairman, vice-chairman, director, and manager of a wholly State-owned company shall not, without the approval of the State-authorized investment entity or State-authorized department, concurrently hold the position

in charge of other limited liability companies, companies limited by shares, or other business organizations.

Article 71: In the transfer of a wholly State-owned company's assets, the State-authorized investment entity, or State-authorized department shall carry out the procedures of examination, approval, and transfer of property rights.

Article 72: A large-scale wholly State-owned company with a sound operation and management system and in good operational conditions may be authorized by the State Council to exercise the rights of the asset-owner.

CHAPTER III: FORMATION AND ORGANIZATIONAL STRUCTURE OF COMPANIES LIMITED BY SHARES

Section I: Formation

Article 73: Formation of a company limited by shares shall meet the following conditions:

(1) the number of promoters satisfies the statutory number;
(2) the amount of share capital subscribed by the promoters and offered to the public satisfies the statutory minimum amount;
(3) the share issuance and preparatory work to comply with the provisions of the law;
(4) the company's articles of association have been formulated by the promoters and passed by the founding meeting;
(5) the company has a name and has established an organizational structure which meets the requirements for a company limited by shares; and
(6) the company has fixed sites for production and operation and satisfies the conditions necessary for production and operation.

Article 74: A joint stock limited company may be established through a promotion method or share-offer method.

Promotion method refers to the case where promoters subscribe to and purchase all of the shares issued by a company for its formation.

Share-offer method refers to the case where promoters subscribe to and purchase a portion of the shares issued by a company and the balance is offered to the public for its formation.

Article 75: In the formation of a company limited by shares, there shall be five or more promoters, among which more than one-half of the promoters must have their domiciles within the territory of China.

Where a State-owned enterprise is transformed into a company limited by shares, there may be less than five promoters, but the share-offer method shall be adopted for its formation.

Article 76: Promoters of a company limited by shares must, according to the provisions of this Company Law, subscribe to and purchase the shares, and undertake the preparatory work for formation of the company.

Article 77: Formation of a company limited by shares must be subject to approval by a department authorized by the State Council or by the People's Government at the provincial level.

Article 78: The registered capital of a company limited by shares shall be the total amount of paid-in share capital registered by the company registration authority.

The minimum amount of registered capital of a company limited by shares shall be RMB 10,000,000 yuan. Where the minimum amount of registered capital of a company limited by shares needs to be higher than the aforesaid prescribed amount, this shall be specified separately in the laws and administrative regulations.

Article 79: The articles of association of a company limited by shares shall provide the following items:

(1) name and domicile of the company;
(2) business scope of the company;
(3) formation method of the company;
(4) the total amount of the company's shares, the value of each share, and the registered capital;
(5) names of promoters and the amount of shares subscribed to and purchased by the promoters;
(6) rights and obligations of shareholders;
(7) constitution, functions and authorities, term of office, and convening rules of the Board of Directors;
(8) legal representative of the company;
(9) constitution, functions, and authorities, term of office, and rules of convening procedures of the Board of Supervisors
(10) method of profit distribution of the company;
(11) reasons for company dissolution and methods of liquidation;
(12) method of notice and public announcement by the company; and
(13) other matters as deemed necessary by the Shareholders' General Meeting.

Article 80: A promoter may contribute capital by means of currency, or of capitalization of tangible property, industrial property, non-patented technologies, or land use rights. The invested tangible property, industrial property rights, non-patented technologies or land use rights must be evaluated and verified, and be converted into shares. Neither over-evaluation nor under-evaluation shall be permitted. The evaluation of the price for the land use rights shall be carried out in accordance with the provisions of the laws and administrative regulations.

The amount of capital contribution by means of capitalizing industrial property rights and non-patented technologies shall not exceed twenty percent of the registered capital of a company limited by shares.

Article 81: When a State-owned enterprise is transformed into a company limited by shares, it shall be strictly prohibited from under-evaluating the State-owned assets while converting them into shares, or selling them at a low value, or distributing them gratis to individuals.

Article 82: If a company limited by shares is formed through the promotion method, after the promoters have fully subscribed in writing to the shares as provided in the company's articles of association, the total subscribed share capital shall be promptly paid. Where tangible property, industrial property rights, non-patented technologies, or land-use rights are offered as capital contribution, the transfer of the property rights shall be carried out in accordance with the law.

After the promoters have paid in all of their capital contribution, they shall elect a Board of Directors and a Board of Supervisors. The Board of Directors shall submit documents such as the document of approval of the formation of the company, the company's articles of association, and the capital verification certificate to the company registration authority in applying for an establishment registration.

Article 83: If a company limited by shares is formed through the share-offer method, the shares subscribed to and purchased by promoters shall not be less than thirty-five percent of the total shares of the company, and the balance shall be offered to the public.

Article 84: When offering shares to the public, the promoters shall lodge a share-offer application with the Securities Administration Department under the State Council, submitting the following major documents:

(1) document of approval for the formation of the company;
(2) the company's articles of association;
(3) the estimate of future earnings;
(4) the names of promoters, the amount of shares subscribed to and purchased by the promoters, types of capital contribution, and the capital verification certificate;

(5) the prospectus;
(6) the name and address of the bank collecting share payments on promoters' behalf; and
(7) the name of the organization contracting for the sale of shares, and relevant agreements.

Promoters shall not be allowed to offer shares to the public without permission from the Securities Administration Department under the State Council.

Article 85: With permission by the State Council Securities Administration Department, a company limited by shares may offer shares abroad. Detailed measures therefore shall be specially provided by the State Council.

Article 86: The Securities Administration Department under the State Council shall approve a public share offer application consistent with conditions provided in this Company Law; and shall not approve a public share offer application inconsistent with the conditions provided in this Law.

If a prior granted approval is found inconsistent with the provisions of this Law, the approval shall be revoked. Where share offer has not started, the offer shall be stopped; where share offer has started, subscribers may request promoters to refund the amount of share payments plus banking deposit interest for the period in question.

Article 87: A prospectus shall be attached to the articles of association formulated by the promoters and state the following items:

(1) the amount of shares subscribed to and purchased by the promoters;
(2) the par value and the issuing price of each share;
(3) the total amount of bearer shares issued;
(4) the rights and obligations of subscribers; and
(5) the starting and ending dates for the period of share subscription, and a statement that subscribers may withdraw their share subscriptions in case shares are not fully subscribed within the time limit.

Article 88: When promoters offer shares to the public, a prospectus must be publicly announced and a subscription form produced. The subscription form shall state the items listed in the preceding Article, shall be filled out by the subscriber showing the number and value of shares he is subscribing and his domicile, and shall be signed and sealed by the subscriber. The subscriber shall pay for the shares he has subscribed to.

Article 89: When promoters offer shares to the public, the sale of shares shall be conducted by a legally-established securities exchange organization and a consignment sales agreement shall be concluded.

Article 90: When promoters offer shares to the public, they shall sign an agreement with a bank for the collection of the share payments on behalf of promoters.

The bank collecting the share payments shall, on behalf of the promoters, collect and hold the share payments according to the agreement, tender receipts to subscribers who have paid in their shares, and assume the obligation of producing evidence of receipt of payments to the relevant authorities.

Article 91: After the issued shares have been fully paid in, the capital shall be verified by a statutory capital-verification organization and a capital-verification certificate shall be issued. Promoters shall convene a founding general meeting within thirty days. The founding general meeting shall consist of subscribers. If the issued shares are not subscribed in full within the time limit provided in the prospectus or, if the promoters fail to convene a founding general meeting within thirty days after the issued shares have been fully paid in, the subscribers may request the promoters to refund the share payments plus banking deposit interest for the period in question.

Article 92: Promoters shall notify every subscriber or make a public announcement of the date of the founding general meeting fifteen days in advance. A founding general meeting is valid only if share subscribers representing more than one-half of the total number of shares are present.

The founding general meeting shall exercise the following functions and authorities:

(1) to examine and discuss promoters's report on the preparatory work for the formation of the company;
(2) to pass the articles of association of the company;
(3) to elect the members of the Board of Directors;
(4) to elect the members of the Board of Supervisors;
(5) to examine and verify the formation expenditure of the company;
(6) to examine and verify the evaluation of the price of property used by promoters in their capital contribution; and
(7) optionally, to adopt a resolution not to form the company if *force majeure* or a substantial change in operational conditions has a direct impact on the formation of the company.

Resolutions at a founding general meeting on matters listed in the preceding paragraph must be passed by a one-half majority of the voting rights of subscribers present at the meeting.

Article 93: Except in circumstances where shares are not subscribed to in full and in time, where promoters fail to convoke a founding general meeting in time, or where the founding general meeting passes a resolution not to establish the

company, promoters and subscribers shall not, after the share payment has been made or the capital in substitution for share payment has been contributed, be allowed to withdraw their share capital.

Article 94: The Board of Directors shall, within thirty days after the conclusion of the founding general meeting, submit the following documents to the company registration authority to apply for an establishment registration.

(1) approval documents issued by the relevant departments in charge;
(2) minutes of the founding general meeting;
(3) articles of association of the company;
(4) financial auditing report for the preparatory work for the formation of the company;
(5) capital-verification certificate;
(6) names and domiciles of members of the Board of Directors and of the Board of Supervisors; and
(7) name and domicile of the legal representative.

Article 95: The company registration authority shall, within thirty days after receiving an application for establishment registration of a company limited by shares, make its decision whether to register the company. The company registration authority shall register and shall issue a business license to a company meeting the conditions provided in this Company Law, and shall not register a company not meeting the conditions provided for in this Law.

The issuing date of the company's business license shall be the date of the establishment of the company. The company shall make a public announcement after its establishment.

After a company limited by shares has been established upon registration, if it has been formed through the share-offer method a report regarding the share offer shall be filed with the Securities Administration Department under the State Council for its record.

Article 96: If a branch is formed at the same time as a company limited by shares, a registration application shall be made to the company registration authorities, and a business license shall be obtained.

If a branch is formed after a company limited by shares, the legal representative of the company shall apply to the company registration authority for registration and issuance of a business license.

Article 97: Promoters of a company limited by shares shall bear the following responsibilities:

(1) in case of failure to establish the company, to bear joint and several liabilities for the indebtedness and expenditure resulting from the forming activities;
(2) in case of failure to establish the company, to bear joint and several liabilities for refunding the share payment already made by subscribers plus banking deposit interest for the period in question; and
(3) in case the company's interests are damaged due to the negligence on the part of promoters during the course of the company's formation, to bear the compensation liabilities toward the company.

Article 98: Where a limited liability company is transformed into a company limited by shares, it shall be consistent with the conditions prescribed in this Company Law, and shall follow the procedure concerning the formation of a company limited by shares provided in this Law.

Article 99: Where a limited liability company is transformed into a company limited by shares subject to approval according to law, the total amount of shares converted shall be equivalent to the value of the net assets of the company. When a limited liability company is transformed into a company limited by shares subject to approval according to law, and it plans to increase its capital by offering shares to the public, procedures regarding public share offer stipulated in this Company Law shall be carried out.

Article 100: Where a limited liability company is transformed into a company limited by shares in accordance with the law, the debts receivable and debts payable by the original limited liability company shall be taken over by the company limited by shares formed after the transformation.

Article 101: A company limited by shares shall keep on the its business premises the company's articles of association, shareholders' register, minutes of the Shareholders' General Meeting, and financial accounting reports.

Section II: Shareholders' General Meeting

Article 102: The Shareholders' General Meeting shall consist of the shareholders of a company limited by shares. The Shareholders' General Meeting shall be the company's organ of authority and shall exercise its functions and authorities in accordance with this Law.

Article 103: The Shareholders' General Meeting shall exercise the following functions and authority:

(1) to decide the company's operational principles and investment plans;
(2) to elect and replace directors, and decide the matter of their remuneration;
(3) to elect and remove the supervisors who are representatives of the shareholders, and decide the matter of their remuneration;
(4) to examine, discuss, and approve reports of the Board of Directors;
(5) to examine, discuss, and approve reports of the Board of Supervisors;
(6) to examine, discuss, and approve the company's annual plans on financial budgets and final accounts;
(7) to examine, discuss, and approve the company's profit distribution plans and loss recovery plans;
(8) to adopt resolutions on the increase or reduction of the company's registered capital;
(9) to adopt resolutions on the issuance of company bonds;
(10) to adopt resolutions on matters such as company merger, separation, dissolution, and liquidation; and
(11) to adopt amendments to the articles of association of the company.

Article 104: The Shareholders' General Meeting shall convene annually. An interim Shareholders' General Meeting shall be convened within two months if one of the following circumstances arises:

(1) if the number of directors is less than two-thirds of the number required by this Company Law or specified in the company's articles of association;
(2) if the company's losses not yet recovered account for one-third of the total amount of share capital;
(3) if shareholders holding ten percent or more of the company's shares petition for a meeting;
(4) if the Board of Directors deems it necessary; or
(5) if the Board of Supervisors proposes a meeting.

Article 105: The Shareholders' General Meeting shall be called by the Board of Directors in accordance with the provisions of this Law and presided over by the chairman of the Board. Where the chairman is not able to perform his functions due to special reasons, the meeting shall be presided over by the vice-chairman or some other director designated by the chairman. Each shareholder shall be notified of the matters to be discussed and examined, thirty days before a Shareholders' General Meeting. An interim Shareholders' General Meeting shall not adopt resolutions regarding matters not listed in the notice.

Where bearer shares are to be issued, the matters mentioned in the preceding paragraph shall be publicly announced forty-five days before the commencement of the meeting.

Five days before the Shareholders' General Meeting, holders of bearer shares shall turn in their share certificates to the company, and the company shall keep the share certificates until the conclusion of the Shareholders' General Meeting.

Article 106: For shareholders present at the Shareholders' General Meeting, there shall be one voting right for each share held by them.

A resolution made at a Shareholders' General Meeting must be passed by a one-half majority of the voting rights of shareholders present at the meeting. A resolution on company merger, separation, or dissolution made at a Shareholders' General Meeting must be passed by a two-thirds majority of the voting rights held by shareholders present at the meeting.

Article 107: An amendment to the company's articles of association must be passed by a two-thirds majority of the voting rights of shareholders present at a Shareholders' General Meeting.

Article 108: A shareholder may authorize a proxy to attend a Shareholders' General Meeting. The proxy shall submit a letter of proxy signed by the shareholder to the company and shall execute voting rights within the scope of authorization.

Article 109: A Shareholders' General Meeting shall draw up minutes concerning the decisions made on matters discussed, and the minutes shall be signed by the directors present at the meeting. Minutes of meetings shall be maintained together with a book of signatures of shareholders present at the meeting and with letters of proxy.

Article 110: A shareholder shall have the right to inspect the company's articles of association, minutes of Shareholders' General Meetings and financial accounting reports, and to offer suggestions for or make inquiries into the company's operations.

Article 111: Where resolutions of the Shareholders' General Meeting and of the Board of Directors are in violation of the laws and administrative regulations and infringe upon the legal rights and interests of shareholders, shareholders shall have the right to file a suit before a People's Court to have the illegal infringing activities stopped.

Section III: The Board of Directors and The Manager

Article 112: A company limited by shares shall establish a Board of Directors of five to nineteen members.

The Board of Directors shall be responsible to the Shareholders' General Meeting and shall exercise the following functions and authority:

(1) to convene the Shareholders' General Meeting and to report its work to the Shareholders' General Meeting;
(2) to implement the resolutions of the Shareholders' General Meeting;
(3) to determine the company's operational and investment plans;
(4) to formulate the company's annual plans on financial budgets and final accounts;
(5) to formulate the company's profit distribution plans and loss recovery plans;
(6) to formulate the company's plans for increasing or reducing the company's registered capital, and for issuing company bonds;
(7) to draft plans of merger, separation and dissolution of the company;
(8) to determine the constitution of the company's internal managerial divisions;
(9) to appoint or dismiss the company's manager, and, based on the manager's nomination, appoint or dismiss the company's deputy manager and leading financial personnel, and decide the matter of their remuneration; and
(10) to formulate the company's fundamental management system.

Article 113: The Board of Directors shall have one chairman and may have one or two vice chairmen. The chairman and vice chairmen shall be elected by the Board of Directors with the approval of a simple majority of all of the directors.

The chairman shall be the legal representative of the company.

Article 114: The chairman shall exercise the following functions and authority:

(1) to preside over the Shareholders' General Meeting, and call and preside over the meetings of the Board of Directors;
(2) to examine the effectiveness of the implementation of resolutions of the Board of Directors; and
(3) to sign the company's share certificates and company bonds.

The vice chairman shall assist the chairman in his duties. If the chairman is not able to perform his functions, the vice chairman designated by the chairman shall perform these functions on the chairman's behalf.

Article 115: The term of office for a director shall be provided in the company's articles of association, but no term shall exceed three years. A director may, after his term has expired, continue to serve additional consecutive terms if re-elected.

The Shareholders' General Meeting shall not, before the term of office of a director has expired, remove the director from his position without justification.

Article 116: The Board of Directors shall convene at least two meetings each year. All directors shall be notified of each meeting ten days in advance.

For an interim meeting of the Board of Directors, the manner and period of advance notice may be stipulated otherwise.

Article 117: A meeting of the Board of Directors shall be convened only if at least one-half of the directors can be present. Resolutions made by the Board of Directors must be passed by a simple majority of all the directors.

Article 118: A director shall attend meetings of the Board of Directors in person. If a director is unable to attend for some reason, he may authorize by a written proxy another director to attend the board meeting on his behalf, and the written proxy shall define the scope of authorization.

The Board of Directors shall draw up minutes of meetings, concerning the resolutions on matters discussed at the meetings. The directors present at the meeting and the minute-taker shall sign the minutes.

Directors shall assume responsibility for resolutions of the Board of Directors. In case the resolutions of the Board of Directors are in violation of the laws, administrative regulations or the articles of association of the company, and cause the company to suffer serious losses, directors participating in the decisions shall bear compensation liabilities toward the company. However, if it is proved that a director has expressed his dissenting opinion during the voting, and his dissenting opinion has been recorded in the minutes of the meeting, this director may be exempt from the liabilities.

Article 119: A company limited by shares shall have a manager appointed or dismissed by the Board of Directors. The manager shall be responsible for the Board of Directors and exercises the following functions and authority:

(1) to be in charge of the management work of production and operation of the company and to implement the Board of Directors' resolutions;
(2) to implement the company's annual operational and investment plans;
(3) to draft plans for the constitution of the company's internal managerial organs;
(4) to draft the company's fundamental management system;
(5) to formulate the detailed rules and regulations of the company;
(6) to propose the appointment or dismissal of the company's deputy managers and leading financial personnel;
(7) to appoint or dismiss managerial personnel other than those appointed or dismissed by the Board of Directors; and
(8) to exercise other functions as specified in the company's articles of association and by the Board of Directors.

The manager shall attend meetings of the Board of Directors as an observer.

Article 120: According to the needs of a company, the Board of Directors may authorize the chairman of the board to perform part of the functions and authorities of the Board of Directors during the period that the board meetings are not in session.

The company's Board of Directors may appoint a member of the Board of Directors concurrently to the position of manager.

Article 121: When considering and acting on matters relating to the employees' immediate or vital interests such as wages, welfare, safety in production, labor protection and labor insurance, a company shall in advance consult the opinions of the company's trade union and employees, and invite the trade unions or employee representatives to attend relevant meetings as observers.

Article 122: When considering and acting on major issues of production and operation and formulating important rules and regulations, a company shall consult the opinions and suggestions of the company's trade union and employees.

Article 123: Directors and managers shall abide by the articles of association of the company, faithfully and honestly perform their functions and authorities, and safeguard the interests of the company, and shall not be allowed to exploit their positions and powers in the company to seek personal gain.

The provisions of Articles 57 to 63 of this Law concerning persons not permitted to hold the post of the director or the manager, and concerning the obligations and responsibilities of the director and manager, shall also apply to the director and manager of a company limited by shares.

Section IV: Board of Supervisors

Article 124: A company limited by shares shall establish a board of supervisors of at least three members. The Board of Supervisors shall choose one convener from its members.

The Board of Supervisors shall consist of shareholders' representatives and the company's employee representatives in an appropriate proportion to be specified in the company's articles of association. The employee representatives on the Board of Directors shall be democratically elected by the company's employees.

A director, manager, or leading financial personnel shall not concurrently hold the position of supervisor.

Article 125: Each term of office of a supervisor shall be three years. After the term of office of a supervisor has expired, he may continue to serve for other consecutive terms if re-elected.

Article 126: A board of supervisors shall exercise the following functions and authority:

(1) to inspect the company's financial matters;
(2) to scrutinize acts of directors and managers during the performance of their functions which are in violation of laws and regulations or the company's articles of association;
(3) to request directors and managers to rectify any of their acts harmful to the interests of the company;
(4) to propose the convening of an interim meeting of the Shareholders' General Meeting; and
(5) other functions and authorities as provided in the company's articles of association.
Supervisors shall attend meetings of the Board of Directors as observers.

Article 127: The manner of convening and the voting procedure of the board of supervisors shall be provided by the company's articles of association.

Article 128: A supervisor shall faithfully and honestly perform his supervisory functions and responsibilities in accordance with laws and administrative regulations and the company's articles of association.

The provisions of Articles 57 to 59 and Articles 62 to 63 of this Law concerning persons not permitted to hold the position of supervisor, and concerning the obligations and responsibilities of supervisor, shall apply to the supervisor of a company limited by shares.

CHAPTER IV: SHARE ISSUANCE AND SHARE TRANSFER OF COMPANIES LIMITED BY SHARES

Section I: Share Issuance

Article 129: The capital of a company limited by shares shall be divided into shares with an equal value for each share.

The share of a company shall be in the form of share certificates. A share certificate is the evidence signed and issued by a company which proves that the shares are held by the shareholders.

Article 130: The issuance of shares shall follow the principles of openness, equality and fairness. All shares of the same type shall have the same rights and benefits.

The issuing conditions and price of each share certificate issued at the same time shall be the same. The price of each share purchased by any unit or individual shall be the same.

Article 131: The issuing price of a share certificate may equal or exceed the par value of the share certificate, but shall not be lower than par value.

Where the issuing price of share certificates exceeds par value, it must be subject to the approval of the Securities Administration Department under the State Council.

The premium gained on shares issued at a price higher than par value shall be listed in the public capital accumulation funds of the company.

Detailed administrative measures for the issuance of share certificates at a premium shall be formulated separately by the State Council.

Article 132: A share certificate shall use the form of a paper certificate or other forms as regulated by the Securities Administration Department under the State Council.

A share certificate shall state the following items:

(1) the name of the company;
(2) the date of the establishment registration of the company;
(3) the type of share, par value, and number of shares represented by the share certificate; and
(4) the serial number of the share certificate.

Share certificates shall be signed by the chairman of the Board of Directors and carry the company's official seal. A share certificate for a promoter shall carry the words "share certificate for promoter."

Article 133: Shares which are issued by a company to promoters, State-authorized investment entities and legal persons shall be in the form of registered shares and shall state the names of these promoters, investment entities or juridical persons; any other names or the names of their representatives shall not be allowed to be used.

Shares issued to the public may be in the form of registered shares or of bearer shares.

Article 134: Where a company issues registered shares, a shareholders' register shall be kept and shall contain the following items:

(1) the shareholders' names and domiciles;
(2) the number of shares held by shareholders;
(3) the serial numbers of share certificates held by each shareholder; and
(4) the dates of acquisition of shares by each shareholder.

Where a company issues bearer shares, the amount of shares, serial numbers, and issuing dates shall be recorded.

Article 135: The State Council may separately stipulate regulations concerning the issuance of types of shares not covered by the provisions of this Law.

Article 136: After the registration of establishment, a company limited by shares shall promptly and formally deliver the share certificates to shareholders. No share certificates shall be delivered to shareholders prior to the registration of the company's establishment.

Article 137: When a company is to issue new shares, the following conditions must be met:

(1) the last previous issue of shares has been fully subscribed and a period of more than one year has elapsed thereafter;
(2) the company has been continuously making a profit and has paid dividends to shareholders during the last three years;
(3) there has been no false entry in the financial accounting documents of the company during the last three years; and
(4) the anticipated profitability rate of the company reaches or exceeds the banking deposit interest rate for the same period.

Where a company uses its current-year profits to distribute new shares, the restriction in item (2) of the preceding paragraph shall not apply.

Article 138: When a company issues new shares, resolutions on the following matters shall be adopted at the Shareholders' General Meeting:

(1) the types and amount of the new shares;
(2) the issuing price of new shares;
(3) the starting and ending dates of the issuance of new shares; and
(4) the types and amount of new shares to be issued to existing shareholders.

Article 139: After a resolution on the issuance of new shares has been adopted by the Shareholders' General Meeting, the Board of Directors must lodge an application with the department authorized by the State Council or to the People's Government at the provincial level for approval. For new shares issued through a public share offer, an approval from the Securities Administration Department under the State Council must be obtained.

Article 140: When a company issues new shares to the public after approval, it must publish the prospectus of the new shares and the financial accounting statements with attached subsidiary schedules, and must produce a subscription form.

In the company's issuance of new shares to the public, the consignment sales of new shares shall be undertaken by legally established stock exchanges and the consignment sales agreements shall be signed by the company and the stock exchanges.

Article 141: In the issuance of new shares, a company may determine its pricing plan according to its continued profitability and the increase in value of its assets.

Article 142: After a company has fully obtained share payments in its issuance of new shares, the company must carry out the procedure for amendment registration with the company registration authority and make a public announcement.

Section II: Share transfer

Article 143: Shares held by shareholders may be transferred in accordance with the law.

Article 144: The share transfer by a shareholder shall be conducted at a legally established stock exchange.

Article 145: Registered shares shall be transferred by shareholders through the method of endorsement or other methods as stipulated in the laws and administrative regulations.

In the transfer of registered shares, the company shall record the name and domicile of the transferee in the shareholders' register.

Within thirty days prior to the convening of the Shareholders' General Meeting or five days prior to the base date chosen by the company for the distribution of dividends, no change shall be made to the shareholders' register described in the preceding paragraph.

Article 146: For the transfer of bearer shares, the transfer shall be valid after a shareholder has handed over such bearer shares to the transferee at a legally established stock exchange.

Article 147: Shares of a company held by its promoters shall not be transferred within three years from the date of establishment of the company.

Directors, supervisors, and managers of a company shall declare to the company the number of the company's shares held by them, and shall not be allowed to transfer these shares during their terms of office.

Article 148: A State-authorized investment entity may, in accordance with the law, transfer shares held by it and purchase shares held by other shareholders.

The approving authority and administrative measures for the transfer or purchase of shares shall be separately specified by the laws and administrative regulations.

Article 149: A company shall not be allowed to purchase its own share certificates, except where the company reduces the company's capital by cancelling its shares or the company merges with another company holding its shares.

After a company has purchased its own shares pursuant to the provisions of the preceding paragraph, this portion of shares must be cancelled within ten days, and an amendment registration shall be carried out in accordance with the laws and administrative regulations and a public announcement shall be made.

A company shall not be allowed to accept its own share certificates as mortgage security.

Article 150: In case of theft, loss, or destruction of a registered share, its shareholder may, pursuant to the procedure of public notice for asserting claims as prescribed in the Code of Civil Procedure, request a People's Court to declare the share certificate invalid.

After the People's Court declares the invalidity of the share certificate according to the procedure of public notice for asserting claims, the shareholder may apply to the company for the reissuance of his share certificate.

Section III: Listed Companies

Article 151: For the purpose of this Law, the term "listed company" refers to a company limited by shares whose issued shares have been approved for listing and trading at stock exchanges by the State Council or the Securities Administration Department authorized by the State Council.

Article 152: A company limited by shares applying for share listing must meet the following conditions:

(1) its shares have already been issued to the public after the approval by the securities administration department under the State Council;
(2) the total amount of the company's share capital is not less than RMB 50,000,000 yuan;
(3) a period of more than three years has elapsed since the company started its business, and it has been continuously showing a profit during the last three years.

Where a company is formed through transforming a previously State-owned enterprise pursuant to the law, or a company is newly formed with large or medium-size State-owned enterprises as principal promoters after this Law goes into effect, the period prior to the formation of the company may be included.

(4) the number of shareholders holding shares with par value of more than RMB 1,000 yuan is not less than 1,000, and shares issued to the public comprise more than twenty-five percent of the company's total shares; for a company whose total share capital exceeds RMB 400,000,000 yuan, the shares issued to the public comprise more than fifteen percent of the total amount of the company's shares;
(5) the company has not committed any significant illicit acts and there is no false entry in the financial statements for the last three years; and
(6) other conditions as stipulated by the State Council.

Article 153: When a company limited by shares applies for listing and trading of its shares, it shall apply to the State Council or the Securities Administration Department authorized by the State Council for approval, and submit relevant documents in accordance with the provisions of relevant laws and administrative regulations.

The State Council or the Securities Administration Department authorized by the State Council shall grant approvals to share-listing applications meeting the conditions provided in this Law; and shall not grant approvals to those not meeting the conditions provided in this Law.

After the share-listing application has been approved, the approved listed company must publish its share-listing report and maintain its application documents in designated places for public inspection.

Article 154: Shares of a listed company which have been approved shall be listed and traded in accordance with the laws and administrative regulations.

Article 155: Upon approval by the Securities Administration Department under the State Council, a company's shares may be listed abroad. The detailed measures shall be separately formulated by the State Council.

Article 156: A listed company must, in accordance with the provisions of the laws and administrative regulations, periodically publish its financial and operational situation, and publish its financial accounting statements every six months within each fiscal year.

Article 157: The Securities Administration Department under the State Council shall decide to suspend the share listing of a listed company should any of the following situations exist:

(1) the total amount of share capital, the structure of share holding, et seq., have been changed so that the company no longer meets the listing conditions;
(2) the company fails to disclose its financial situations pursuant to the regulations or makes false entries in its financial accounting reports;

(3) the company has committed a major illegal act; or
(4) the company has continuously suffered losses during the last three years.

Article 158: If a listed company faces a situation as described in item (2) or (3) of the preceding Article which is found to have serious consequences, or faces a situation as described in item (1) or (4) of the preceding Article which cannot be eliminated within the prescribed period and the requirements for listing are no longer satisfied, the Securities Administration Department under the State Council shall terminate the share listing of the company.

If a company has made a resolution of dissolution, has been ordered by the competent department in charge to close down in accordance with the law, or has been declared bankrupt, the Securities Administration Department under the State Council shall terminate the share listing of the company.

CHAPTER V: COMPANY BONDS

Article 159: A company limited by shares, a wholly-owned State company, or a limited liability company established through investment by two or more State-owned enterprises or by two or more State-owned investment entities may, in order to raise funds for its production and operation, issue company bonds in accordance with the provisions of this Law.

Article 160: For the purpose of this Law, "company bonds" shall refer to securities of value issued by a company in accordance with legal procedures and on which the company promises to pay principal and interest within a specified period of time.

Article 161: The following conditions must be met in the issuance of company bonds:

(1) the net assets of a company limited by shares are not less than RMB 30,000,000 yuan and the net assets of a limited liability company are not less than RMB 60,000,000 yuan;
(2) the aggregate accumulated amount of company bonds does not exceed forty percent of the company's net assets;
(3) the average annual distributable profits for the immediately preceding three years are sufficient to pay one year's interest on company bonds;
(4) the investment orientation of the raised funds conforms to the State industrial policies;
(5) the interest rate of company bonds shall not exceed the limit specified by the State Council; and
(6) other conditions as stipulated by the State Council.

The funds raised through the issuance of company bonds must be used for the purposes approved by the examination and approval authority and shall not be used to cover loss or for non-production expenditures.

Article 162: A company shall not re-issue company bonds again should any of the following situations arise:

(1) the last preceding issue of company bonds has not been fully subscribed; or
(2) a breach of contract or a delayed payment of principal or interest has occurred with respect to its already issued company bonds or to its debts payable, and this situation is continuing.

Article 163: In the issuance of company bonds by a company limited by shares or a limited liability company, the company's Board of Directors shall formulate a plan to be passed at the Shareholders' Meeting in the form of a resolution.

The decision to issue company bonds by a wholly State-owned company shall be made by the State-authorized investment entity or the State-authorized department.

After a resolution or decision has been made according to the two preceding paragraphs, the company shall apply for approval to the securities administration department under the State Council.

Article 164: The scale for the issuance of company bonds shall be determined by the State Council. In granting approval for the issuance of company bonds, the securities administration department under the State Council shall not be allowed to exceed the scale determined by the State Council.

The Securities Administration Department under the State Council shall grant approvals to applications for issuance of company bonds which are consistent with the provisions of this Law, and shall not grant approval to those not consistent with the provisions of this Law.

Where an already-granted approval is found to be inconsistent with the provisions of this Law, it shall be revoked. If the company bonds have not been issued, the issuance shall be prevented; if the company bonds have already been issued, the issuing company shall refund the subscribers' payments plus banking deposit interest for the period in question.

Article 165: When applying to the securities administration department under the State Council for approval of the issuance of company bonds, a company shall submit the following documents:

(1) the company's registration certificate;
(2) the company's articles of association;

(3) the subscription method for issuing company bonds; and
(4) the asset evaluation report and capital verification report.

Article 166: After an application for the issuance of company bonds has been approved, the subscription method for issuing the company bonds shall be disclosed.

The subscription method of issuing company bonds shall furnish the following items:

(1) the company's name;
(2) the total amount of company bonds and their par value;
(3) the interest rate of company bonds;
(4) the time limits and method for the payment of principal and interest;
(5) the starting and ending dates for the issuance of company bonds;
(6) the amount of the company's net assets;
(7) the total amount of undue company bonds already issued; and
(8) the consignment sales organization for the company bonds.

Article 167: In issuing company bonds, a company must state on company bonds such items as the company's name, par value, interest rate, and repayment schedule, and the company bonds shall be signed by the chairman of the Board of Directors and be sealed by the company.

Article 168: Company bonds may be divided into registered bonds and bearer bonds.

Article 169: In issuing company bonds, a company shall keep a counterfoil record book of company bonds.

When issuing registered company bonds, the counterfoil book of company bonds shall include the following items:

(1) the names and domiciles of bond holders;
(2) the date of acquisition by the bond holder and serial number of the bond;
(3) the total amount of bonds, par value of bonds, interest rate of bonds, and schedule and method for the payment of principal and interest; and
(4) the issuing date of company bonds.

In issuing bearer company bonds, the counterfoil record book of company bonds shall include the total amount of company bonds, interest rate, schedule and method of payment, issuing date and serial numbers of company bonds.

Article 170: Company bonds may be transferable. The transfer of company bonds shall be conducted at legally established stock exchanges.

The transfer price of company bonds shall be agreed upon by transferor and transferee.

Article 171: Registered bonds shall be transferred through the endorsement by bond holders or through other methods as stipulated in the laws and administrative regulations.

In the transfer of registered bonds, the company shall record the names and domiciles of the transferee in the counterfoil record book of the company bonds.

The transfer of bearer bonds shall become effective after the bond holders have handed over the bond certificates to the transferee at legally established stock exchanges.

Article 172: A listed company may, subject to the resolution of the Shareholders' General Meeting, issue company bonds that can be converted into shares, and include in the bond subscription methods the detailed conversion method.

The issuance of bonds convertible into shares shall be subject to approval by the securities administration department under the State Council. In issuing company bonds convertible into shares, in addition to meeting the conditions of issuing company bonds, it must meet the conditions of issuing shares.

In issuing bonds convertible into shares, the words "convertible company bond" shall be marked on the bonds and the amount of such convertible bonds shall be recorded in the counterfoil record book of the company bonds.

Article 173: Where company bonds convertible into shares are issued, a company shall, according to its conversion method, offer share certificates to bond holders, but bond holders shall have the right to choose whether or not to convert company bonds into shares.

CHAPTER VI: FINANCIAL AFFAIRS AND ACCOUNTING OF COMPANIES

Article 174: A company shall, in accordance with the laws, administrative regulations and the regulations of the competent financial department of the State Council, establish its financial and accounting system.

Article 175: A company shall produce financial and accounting reports at the end of each fiscal year and, according to the law, submit these reports for examination and verification.

A financial accounting report shall include the following financial accounting statements with attached subsidiary schedules:

(1) the balance sheet;
(2) the statement of profit and loss;
(3) the report of variation in financial situation;

(4) the statement of financial situation; and
(5) the profit-distribution statement.

Article 176: A limited liability company shall submit its financial accounting reports to each shareholder within the time limit provided in the company's articles of association.

A company limited by shares shall make its financial accounting reports available at the company for inspection by shareholders twenty days before the convening of its annual Shareholders' General Meeting.

A company limited by shares established through the public share offer manner must disclose its financial accounting reports.

Article 177: When distributing the post-tax profit for the current year, a company shall allocate ten percent of that profit to the statutory public-accumulation fund and five to ten percent of that profit into the statutory public-welfare fund. If the aggregate amount already contributed to the statutory public-accumulation funds exceeds fifty percent of the company's registered capital, further allocation may not be required.

If a company's existing statutory public-accumulation fund is insufficient to make up for losses incurred by the company during the previous year, the current year's profit shall be used first to make up those losses before the allocations to the statutory public accumulation fund and public welfare fund are made in accordance with the provisions of the preceding paragraph.

After contributing to the statutory public-accumulation fund and public welfare fund from post-tax profit, a company may, subject to the approval by the Shareholders' Meeting, contribute an optional public-accumulation fund.

The profit remaining after the restoration of losses and the allocations to the public-accumulation fund and statutory public-welfare fund shall be distributed to shareholders in proportion to the capital distribution of the shareholders in case of a limited liability company, and in proportion to the shares held by shareholders in case of a company limited by shares.

In case the Shareholders' Meeting or the Board of Directors acts in violation of the provisions of the preceding paragraph by distributing profits to shareholders before the restoration of losses and allocations to the statutory public accumulation and welfare funds, those profits distributed in violation of the provisions must be returned to the company.

Article 178: Premium obtained from shares issued by a company limited by shares according to the law with an issuing price higher than par value, as well as other income regulated by the competent Financial Department of the State Council to be listed in public capital accumulation fund, shall be allocated to the company public capital accumulation fund.

Article 179: A company's public-accumulation fund shall be used to make up the losses of the company, to expand its production and operation, or to be transferred to increase the company's capital.

When a company, upon a resolution of the Shareholders' General Meeting, decides to convert the public-accumulation fund into capital, the company shall, according to the existing proportion of shares held by each shareholder, issue new shares to each shareholder, or increase the par value of each share. However, when the statutory public accumulation fund is transferred into capital, the balance of this public-accumulation fund shall not be less than twenty-five percent of the registered capital.

Article 180: The statutory public-welfare fund allocated by a company shall be used for the collective welfare of the company's employees.

Article 181: A company shall not be allowed to set up accounting books other than those mandated by law.

It shall not be allowed to deposit a company's assets by opening an account in the name of any individual.

CHAPTER VII: COMPANY MERGER AND DIVISION

Article 182: Company merger or division shall be subject to a resolution passed by the Shareholders' Meeting.

Article 183: The merger or division of a company limited by shares shall be subject to approval by a department authorized by the State Council or by the People's Government at the provincial level.

Article 184: The company merger may be carried out by the merger-through-absorption method or the merger-through-a-new-establishment method.

The merger-through-absorption method refers to the situation in which a company takes over another company and the latter is dissolved. The merger-through-new-establishment refers to the situation in which two or more companies consolidate and establish a new company, and the parties to the merger are dissolved.

In company merger, parties to the merger shall sign a merger agreement and a balance sheet and a statement of property inventory shall be prepared. A company shall, after a resolution on merger has been passed, notify its creditors within ten days and make public announcement at least three times in the newspapers within thirty days. Creditors shall, within thirty days after receiving the notice, or, if not receiving the notice, within ninety days after the first public announcement, have the right to request the company to settle its debts or to provide equivalent guarantees. If the debts have not been settled or equivalent guarantees provided, the company shall not be allowed to merge.

In company merger, the debts receivable and debts payable of the various parties to the merger shall, after the merger, be taken over by the surviving company or the newly- established company.

Article 185: In case of company division, the company assets shall be appropriately separated.

In company division, a balance sheet and a statement of property inventory shall be prepared. The company shall, after a resolution on separation has been passed, notify its creditors within ten days, and make public announcement at least three times in the newspapers within thirty days. Creditors shall, within thirty days after receiving the notice, or, if not receiving the notice, within ninety days after the first public announcement, have the right to request the company to settle its debts or provide equivalent guarantees. If the debts have not been settled or equivalent guarantees provided, the company shall not be allowed to divide.

The debts payable before the division of the company shall be assumed by the companies after the division according to the agreement reached.

Article 186: Where a company needs to reduce its registered capital, it must prepare a balance sheet and a statement of property inventory.

A company shall, after a resolution on the reduction of registered capital has been passed, notify its creditors within ten days, and make public announcement at least three times within thirty days. Creditors shall, within thirty days after receiving the notice, or, if not receiving the notice, within ninety days after the first public announcement, have the right to request the company to repay its debts or provide equivalent guarantees.

Registered capital after the company's reduction of its capital shall not be allowed to be less than the statutory minimum amount.

Article 187: When a limited liability company increases its registered capital, the capital contributions made by shareholders in the subscription of newly-increased capital shall be carried out in accordance with relevant provisions of this Law concerning the capital contribution in the formation of a limited liability company.

When a company limited by shares increases its registered capital by issuing new shares, the purchase of new shares by shareholders shall be carried out in accordance with relevant provisions of this Law concerning the share payment in the formation of a company limited by shares.

Article 188: If registered items have been changed as a result of the company merger or division, the company shall submit an amendment registration to the company registration authority according to law; in the case of the dissolution of a company, the company shall submit a cancellation registration according to law;

in the case of the establishment of a new company, the company shall submit an establishment registration according to law.

When a company increases or reduces its registered capital, the company shall submit an amended registration to the company registration authority according to law.

CHAPTER VIII: BANKRUPTCY, DISSOLUTION AND LIQUIDATION OF COMPANIES

Article 189: If a company is declared bankrupt according to law because of its inability to repay debts due, a People's Court shall, in accordance with the provisions of relevant laws, organize shareholders, appropriate authorities, and appropriate professionals to establish a liquidation panel to carry out the bankruptcy liquidation of the company.

Article 190: A company may be dissolved should any of the following situations arise:

(1) the term of business operation provided in the company's articles of association has expired or other reasons for dissolution as provided in the company's articles of association have arisen;
(2) the Shareholders' Meeting has passed a resolution of dissolution; or
(3) dissolution becomes necessary because of company merger or division.

Article 191: If a company is dissolved according to the provisions of items (1) and (2) of the preceding Article, a liquidation panel shall be established within fifteen days. In case of a limited liability company, the liquidation panel shall consist of shareholders; in case of a company limited by shares, the members of the liquidation panel shall be chosen by the Shareholders' General Meeting. If a liquidation panel is not established before the expiration of the time limit to carry out liquidation, the debtors may apply to a People's Court to appoint appropriate personnel to form a liquidation panel to carry out liquidation. The People's Court shall accept such application and in a timely manner appoint members of the liquidation panel to carry out the liquidation.

Article 192: If a company has been ordered to terminate in accordance with law because of its violation of laws and administrative regulations, this company shall be dissolved. An appropriate competent department shall organize shareholders and appropriate authorities and professionals to form a liquidation panel to carry out liquidation.

Article 193: A liquidation panel shall exercise the following functions and authorities:

(1) to ascertain the company's property, and prepare a balance sheet and an inventory of property;
(2) to notify or make public announcement to creditors;
(3) to handle and liquidate the unfinished business involving the company;
(4) to pay any taxes owed;
(5) to clear debts receivable and debts payable;
(6) of the remaining assets after all debts payable have been paid; and
(7) to represent the company in civil litigation proceedings.

Article 194: A liquidation panel shall, after its establishment, notify creditors within ten days and publish announcements at least three times in the newspapers within sixty days. Creditors shall, within thirty days after receiving the notice, or, if not receiving the notice, within ninety days after the first public announcement, present claims for their debts receivable to the liquidation panel.

In presenting claims, creditors shall explain any matters relevant to their debts receivable and shall provide evidentiary documentation. The liquidation panel shall register the debts receivable.

Article 195: After ascertaining the company's property and preparing a balance sheet and statement of property inventory, the liquidation panel shall formulate a liquidation plan and submit it to the Shareholders' Meeting or appropriate competent authorities for confirmation.

If a company's property is sufficient to repay its debts, its property shall be used to pay, in this order: expenses of liquidation, employees' wages and labor insurance expenses, taxes owed, and the company's debts.

Any company property remaining after all payments have been made according to the provisions of the preceding paragraph shall be distributed in the case of a limited liability company in proportion to the shareholders' capital contributions, and in the case of a company limited by shares in proportion to the shares held by shareholders.

A company shall not, during the period of liquidation, conduct any new business. A company's property shall not be distributed to the shareholders before the liquidation has been completed in accordance with the provisions of the second paragraph of this Article.

Article 196: In case a company is liquidated because of dissolution, if the liquidation panel, after ascertaining the company's property and preparing a balance sheet and an inventory of property, finds that the company's assets are not sufficient to repay its debts, the panel shall promptly apply to a People's Court for a bankruptcy declaration.

After a company has been declared bankrupt by a decision of the People's Court, the liquidation panel shall hand the liquidation over to the People's Court.

Article 197: After completing the liquidation of a company, the liquidation panel shall prepare a liquidation report, submit it to the shareholder's meeting or appropriate competent authorities for confirmation, apply to the company registration authority for a company cancellation registration, and make a public announcement on the termination of the company. If no application for the company cancellation registration is made, the company registration authority shall cancel the company's business license and make a public announcement.

Article 198: Members of a liquidation panel shall be faithful to their duties and perform their obligations in accordance with the law.

Members of a liquidation panel shall not be allowed to exploit their power by accepting bribes or other illegal gain, and shall not be allowed to seize the company's property illegally.

If a member of a liquidation panel causes losses to the company or the creditors deliberately or with serious negligence, he shall bear compensation liabilities.

CHAPTER IX: BRANCHES OF FOREIGN COMPANIES

Article 199: A foreign company may, according to the provisions of this Law, establish its branches within the territory of China to engage in productive and operational activities.

For the purpose of this Law, the term "foreign company" refers to a company registered and established outside the territory of China according to the law of a foreign country.

Article 200: When establishing a branch within the territory of China, a foreign company must lodge an application with a competent Chinese authority and submit documents such as the company's articles of association and the company registration certificate issued by its home country. After being approved, the foreign company shall carry out registration procedures with the company registration authority according to the law and obtain a business license.

The approval procedures concerning branches of foreign companies shall be provided separately by the State Council.

Article 201: When establishing a branch within the territory of China, a foreign company must appoint within the territory of China a representative or agent in charge of this branch and provide funds compatible with its operational and business activities.

Where necessary the State Council shall specify the minimum amount of operational fund required for a branch of a foreign company.

Article 202: A branch of a foreign company shall indicate in its name the nationality and the form of liability of the foreign company.

A branch of a foreign company shall keep on its business premises a copy of the articles of association of the foreign company.

Article 203: A foreign company is a foreign juridical person, and its branches established within the territory of China shall not have the status of Chinese juridical person.

A foreign company shall bear civil liabilities for the operational activities conducted by its branches within the territory of China.

Article 204: A foreign company's branch established upon approval must abide by the laws of China when conducting business activities within the territory of China, and shall not harm the public interests of China. Its legal rights and interests shall be protected by Chinese law.

Article 205: When terminating its branches in China, a foreign company must repay its debts according to law and carry out their liquidation according to the provisions of this Law which concern the procedures of company liquidation. Prior to the settlement and repayment of the debts, the property of the branches shall not be transferred out of the territory of China.

CHAPTER X: LEGAL LIABILITIES

Article 206: During company registration, if a company attempts to obtain company registration in violation of the provisions of this Law by falsely reporting its registered capital, submitting false documents, or concealing important facts by other deceptive means, this company shall be ordered to rectify the situation. If a company falsely reports its registered capital, a fine of five to ten percent of the amount of the falsely-reported registered capital shall be imposed; if a company submits false documents or conceals important facts by other deceptive means, a fine of RMB 10,000 to RMB 100,000 yuan shall be imposed. If the circumstance is serious, the company's registration shall be revoked; if the act constitutes a criminal offense, criminal liability shall be imposed in accordance with law.

Article 207: Where a company issues shares or company bonds with a false prospectus, subscription form or company bond subscription methods, it shall be ordered to halt the issuance and to refund the paid-in capital and interest, and a fine of one to five percent of the amount of illegally-collected monies shall be imposed. If the act constitutes a criminal offense, criminal liability shall be imposed in accordance with law.

Article 208: If a promoter or shareholder of a company does not hand over currency or tangible property or does not transfer property rights, but falsifies his capital contribution to deceive the creditors and the public, he shall be ordered to rectify the situation, and a fine of five to ten percent of the falsified capital contribution shall be imposed. If the act constitutes a criminal offense, criminal liability shall be imposed in accordance with the law.

Article 209: If a promoter or shareholder of a company withdraws his capital contribution after the establishment of the company, a fine of five to ten percent of the amount of withdrawn capital contribution shall be imposed. If the act constitutes a criminal offense, criminal liability shall be imposed in accordance with the law.

Article 210: If a company issues shares or company bonds without the approval of the appropriate competent authorities as prescribed in this Law, it shall be ordered to halt the share issuance and to refund the collected moneys and the interest, and a fine of one to five percent of the amount of such illegally-collected monies shall be imposed. If the act constitutes a criminal offense, criminal liability shall be imposed in accordance with the law.

Article 211: If a company, in violation of the provisions of this Law, establishes accounting books in addition to those mandated by law, it shall be ordered to rectify the situation, and a fine of RMB 10,000 to RMB 100,000 yuan shall be imposed. If the act constitutes a criminal offense, criminal liability shall be imposed in accordance with the law.

If the company's assets are deposited in accounts opened in the names of individuals, any illegal gains shall be confiscated, and a fine of one to five times the amount of illegal gains shall be imposed. If the act constitutes a criminal offense, criminal liability shall be imposed according to law.

Article 212: If a company provides shareholders and the general public with financial accounting reports which are false or which conceal important facts, a fine of RMB 10,000 to RMB 100,000 yuan shall be imposed on the personnel directly in charge and other personnel directly responsible. If the act constitutes a criminal offense, criminal liability shall be imposed in accordance with the law.

Article 213: If a company in violation of the provisions of this Law converts State-owned assets into shares at a price lower than the real value, sells such assets at a price lower than the real value, or contributes such assets gratis to individuals, administrative punishment shall be imposed on the personnel directly in charge and other personnel directly responsible. If the act constitutes a criminal offense, criminal liability shall be imposed in accordance with the law.

Article 214: If a director, supervisor or manager exploits his power and accepts bribes and other illegal gain or seizes company property, such illegal gain shall be confiscated, and he shall be ordered to return the company property and be punished by the company. If the act constitutes a criminal offense, criminal liability shall be imposed in accordance with the law.

If a director or manager embezzles company funds or lends company funds to others, he shall be ordered to return the company funds and be punished by the company, and his profits shall be taken over by the company. If the act constitutes a crime, criminal liability shall be imposed in accordance to the law.

If a director or manager, in violation of the provisions of this Law, uses company property to guarantee the debts of shareholders or other individuals, he shall be ordered to cancel that guarantee, to assume compensation liabilities according to the law, and to return to the company the profits gained from the illegal guarantee. If the circumstances are serious he shall be punished by the company.

Article 215: If a director or manager in violation of the provisions of this Law operates on his own behalf or on behalf of another a business of a nature similar to the business of the company where he holds his position, his profit shall be taken over by the company, and he may be punished by the company.

Article 216: If a company fails to allocate funds to the statutory public-accumulation fund and statutory public-welfare fund in accordance with this Law, it shall be ordered to contribute to this fund to the full amount due, and a fine of RMB 10,000 to RMB 100,000 yuan shall be imposed.

Article 217: If a company fails to notify or make public announcement to creditors in accordance with the provisions of this Law in its merger, separation, reduction of registered capital or liquidation, it shall be ordered to rectify the situation, and a fine of RMB 10,000 to RMB 100,000 yuan shall be imposed on the company.

If a company in liquidation conceals property, enters false records on the balance sheet or the property inventory, or distributes company property prior to the repayment of its debts, it shall be ordered to rectify the situation, and a fine of one to five percent of the value of the property concealed or distributed prior to the repayment of debts shall be imposed on the company. A fine of RMB 10,000 to RMB 100,000 shall be imposed on the personnel directly in charge and other personnel directly responsible. If the act constitutes a criminal offense, criminal liability shall be imposed according to the law.

Article 218: If a liquidation panel fails to submit its liquidation report to the company registration authority according to the provisions of this Law, or its liquidation report conceals important facts or has major omissions, it shall be ordered to rectify the situation.

If a member of a liquidation panel exploits his power to practice favoritism or fraud, seeks illegal gain, or seizes company property, he shall be ordered to return the company property, his illegal gain shall be confiscated, and a fine of one to five times the illegal gain may be imposed. If the act constitutes a criminal offense, criminal liability shall be imposed in accordance with the law.

Article 219: If an organization conducting asset evaluation, capital verification or authentication provides false documents, its illegal gains shall be confiscated, a fine of one to five times the illegal gains shall be imposed, and an appropriate competent department may, in accordance with the law, order this organization to suspend its business operation, and may revoke the qualification certificates of personnel directly responsible. If the act constitutes a criminal offense, criminal liability shall be imposed in accordance with the law.

If an organization undertaking asset evaluation, capital verification, or authentication provides reports with major omissions due to negligence, it shall be ordered to rectify the situation; if the circumstance is relatively serious, a fine of one to three times its illegal gain shall be imposed and the appropriate competent authorities may also order this organization to suspend its business operation, and revoke the qualification certificates of personnel directly responsible.

Article 220: If an appropriate competent department authorized by the State Council approves an application for company establishment which does not meet the conditions provided in this Law, or an application for share issuance which does not meet the conditions provided in this Law, and if the circumstances are serious, an administrative punishment shall be imposed on the personnel directly in charge and other personnel directly responsible. If the act constitutes a criminal offense, criminal liability shall be imposed in accordance with the law.

Article 221: If the securities administration department under the State Council grants approval to an application for public share offer, share listing or issuance of company bonds which does not meet the conditions as provided in this Law, and if the circumstances are serious, administrative punishment shall be imposed on the personnel directly in charge and other personnel directly responsible. If the act constitutes a criminal offense, criminal liability shall be imposed in accordance with the law.

Article 222: If the company registration authority approves a registration application inconsistent with the conditions provided in this Law, administrative punishment shall be imposed on the personnel directly in charge and other personnel directly responsible. If the act constitutes a criminal offense, criminal liability shall be imposed in accordance with the law.

Article 223: If a department at a higher level of the company registration authority forces the company registration authority to approve a registration application which does not meet the conditions provided in this Law, or conceals an illegal registration, administrative punishment shall be imposed on the personnel directly in charge and other personnel directly responsible. If the act constitutes a criminal offense, criminal liability shall be imposed in accordance with law.

Article 224: If an entity, without being registered as a limited liability company or a company limited by shares according to the law, falsely uses the name of a limited liability company or a company limited by shares, it shall be ordered to rectify the situation, or the entity shall be closed, and a fine of RMB 10,000 to RMB 100,000 yuan may also be imposed. If the act constitutes a criminal offense, criminal liability shall be imposed in accordance with law.

Article 225: If a company fails without justification to start its business within six months of its establishment, or automatically suspends its business for a continuous period of six months, the company registration authority shall revoke its company business license.

If items in a company registration have been changed, and the company does not carry out an appropriate amendment registration according to this Law, it shall be ordered to carry out the amendment registration within a prescribed time limit. If an amendment registration is not carried out within the prescribed time limit, a fine of RMB 10,000 to RMB 100,000 yuan shall be imposed.

Article 226: If a foreign company, in violation of the provisions of this Law, establishes its branch without approval within the territory of China, it shall be ordered to rectify the situation, or the branch shall be closed, and a fine of RMB 10,000 to RMB 100,000 may be imposed.

Article 227: If appropriate competent departments performing their functions of examination and approval according to this Law fail to approve an application which meets the statutory conditions, or if the company registration authority fails to approve a registration application which meets the statutory conditions, the submitting parties may in accordance with the law apply for a review or file an administrative suit.

Article 228: If a company's violation of the provisions of this Law leads to the imposition of civil compensation liabilities, and fines and pecuniary penalties, if its property is insufficient to satisfy all these obligations, it shall first satisfy its civil compensation liabilities.

CHAPTER XI: ANCILLARY PROVISIONS

Article 229: Companies established through registration pursuant to the laws, administrative regulations, local regulations, the "Standard Opinions on Limited Liability Companies," and the "Standard Opinions on Joint Stock Limited Companies" shall be retained. Those which do not fully meet these conditions provided in this Law shall, within a prescribed time limit, satisfy the conditions. Detailed implementation measures shall be separately formulated by the State Council.

Article 230: This Law shall go into effect July 1, 1994.