POLICY ANALYSIS OF FOREIGN INVESTMENT COMPANIES LIMITED BY SHARES

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ABSTRACT

China permits foreign investors to establish foreign investment companies limited by shares (FICLBS) together with Chinese domestic investors after 1995. FICLBS are a new form of foreign investment in addition to Sino-foreign Equity Joint Ventures, Sino-foreign Contractual Joint Ventures and Wholly Foreign Owned Enterprises. In the meantime, FICLBS have close relations with and are strictly governed by PRC Company Law. The double nature of FICLBS accounts for many characteristics of FICLBS.

As a form of foreign investment, FICLBS are based on the foreign investment regime. FICLBS are governed by the legal provisions relating to foreign investment regime. At the same time, various State and Party policies give various characteristics to FICLBS and make them different from other foreign investment enterprises.

As a form of modern company, FICLBS are greatly influenced by both civil law and common law as a result of the policy of joining the world economy. This thesis focuses on the common law influences. The influences of common law on FICLBS are manifest in various respects. On the other hand, various Chinese characteristics are intentionally remained. These Chinese characteristics can be found in many important phases and aspects of FICLBS such as corporate capacity, corporate governance, shares and dividends.

The contradicting characteristics of FICLBS are a product of the contradicting State and Party policies underlying them. On one hand, China adopts the opening-up policy and has been making constant efforts to join the world economy. On the other hand, China has always been trying to maintain the so-called Chinese characteristics despite the fact that there is no generally accepted definition of Chinese characteristics.

Although China has always been committed to keeping its policies consistent, the unstable nature of the policy basis of FICLBS will inevitably affect the future of FICLBS. However, since the opening-up policy of China will not possibly be reversed in the future, FICLBS will remain available for foreign investors no matter how the specific policies are changed.
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CHAPTER I  INTRODUCTION

On January 10, 1995, the Ministry of Foreign Trade and Economic Co-operation of the People’s Republic of China (hereinafter referred to as MOFTEC) promulgated the Provisional Regulations on the Establishment of Foreign Investment Companies Limited by Shares (Guanyu sheli waishang touzi gufen youxian gongsi ruogcm wenti de zanxing guiding) (hereinafter referred to as Provisional Regulations on FICLBS). This is the first step which formally permits foreign investors to take part in companies limited by shares in China. Foreign investment companies limited by shares (hereinafter referred to as FICLBS) have many characteristics which deserve detailed research. The most important characteristic of FICLBS is that they are a combination of foreign investment enterprise and modern company.

According to the Provisional Regulations on FICLBS, FICLBS shall be established under the Provisional Regulations on FICLBS. The total capital of FICLBS shall be divided into shares of equal amount. The shareholders of FICLBS shall bear liabilities to the company to the extent of the capital they subscribed. FICLBS bear liability to the extent of all the assets for the debts of the company. FICLBS are enterprise legal persons. Both Chinese and foreign shareholders jointly hold the shares of the company. The shares bought and held by foreign shareholders shall account for over 25% of the capital of the company. The above definition can be divided into two sections. What is defined in the

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1 Both the Chinese version and English translation can be found in China Laws for Foreign Business: Business Regulation, vol. 2 (CCH Australia Ltd.) ¶13-405 [hereinafter CCH: Business Regulation].

2 Provisional Regulations on FICLBS, art. 2.
first section is a company limited by shares as defined in Company Law of the People’s Republic of China (*Zhonghua renmin gongheguo gongsifa*)\(^3\). Furthermore, Provisional Regulations on FICLBS expressly provide that FICLBS shall be governed by PRC Company Law.\(^4\) Therefore, FICLBS have many characteristics in the context of the company law. What is defined in the second section (the last two sentences) is a Sino-foreign equity joint venture as defined in Sino-foreign Equity Joint Venture Law of the People’s Republic of China (*Zhonghua renmin gongheguo zhongwai hezi jingying qiye fa*) (hereinafter EJV Law).\(^5\) Provisional Regulations on FICLBS expressly provide that FICLBS are a form of foreign investment enterprises and shall be governed by the relevant provisions of foreign investment.\(^6\) Therefore, FICLBS have many characteristics in the context of foreign investment law.

As a combination of foreign investment enterprise and company limited by shares, FICLBS are a new form of foreign investment enterprises as distinguished from Sino-foreign equity joint ventures (hereinafter referred to as EJV),\(^7\) wholly foreign owned enterprises (hereinafter referred to as WFOE)\(^8\)

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\(^3\) Company Law of the People’s Republic of China (hereinafter “PRC Company Law”) was adopted at the Fifth Session of the Standing Committee of the Eighth National People’s Congress of PRC on 29 December 1993. Both the Chinese version and an English translation can be found in *CCH: Business Regulation*, vol. 2, *supra* note 1 ¶13-518. Article 3 of PRC Company Law provides exactly the same definition: “a company limited by shares is an enterprise legal person whose total capital is divided into equal shares, each shareholder shall assume liability to the company to the extent of the amount of shares held by him, and the company shall be liable for its debts to the extent of all its assets.”

\(^4\) Provisional Regulations on FICLBS, art. 25.

\(^5\) EJV Law, adopted 1 July 1979 at the Second Session of the Fifth National People’s Congress, amended 4 April 1990 at the Third Session of the Seventh National People’s Congress. Both the Chinese version and English translation can be found in *CCH: Business Regulation*, vol. 1, *supra* note 1 ¶ 6-500. Article 1 of EJV Law provides that a joint venture company shall be established jointly by Chinese and foreign investors. Article 4 of the same law provides that the capital contributed by the foreign investors shall not be less than 25% of the registered capital of an equity joint venture company.

\(^6\) Provisional Regulation on FICLBS, art. 3.

\(^7\) They were first permitted to be established with the adoption of EJV Law in 1979. See *supra* note 5.
and Sino-foreign contractual joint ventures (hereinafter referred to as CJV)\(^9\) which were the only three forms of foreign investment before the permission of FICLBS (hereinafter collectively referred to as the General Foreign Investment Regime). This is because all the previous three forms of foreign investment are limited liability companies if they have independent legal person status.\(^{10}\) Under the PRC Company Law, companies are divided into two kinds, one is limited liability company and the other is companies limited by shares.\(^{11}\) Hence, FICLBS should be regarded as a fourth form of foreign investment enterprises in addition to EJV, CJV and WFOE.

This thesis intends to analyse FICLBS in two contexts -- foreign investment law and company law. In this thesis, I will first review the policies underlying the legal regime of FICLBS. Policies of both the Communist Party of China (hereinafter the CPC) and State constitute the basis of the

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\(^{8}\) They were first permitted to be established with the adoption of Wholly Foreign Owned Enterprise Law of PRC (Zhonghua renmin gongheguo waizi qiye fa) at the Fourth Session of the Sixth National People's Congress on April 12, 1986 [hereinafter referred to as WFOE Law]. Both the Chinese version and an English translation can be found in CCH: Business Regulation, vol. 2, supra note 1 ¶13-506.

\(^{9}\) They were first permitted to be established with the adoption of Sino-foreign Contractual Joint Venture Law of PRC (Zhonghua renmin gongheguo zhongwai hezuo jingying qiye fa) at the First Session of the Seventh National People's Congress on April 13, 1988 [hereinafter CJV Law]. Both the Chinese version and English translation can be found in CCH: Business Regulation, vol. 1, supra note 1 ¶6-100.


\(^{11}\) PRC Company Law, art. 2.
legislation of China. The legislation authorities in China are subject to the leadership of the CPC. It is believed that laws are formulated in accordance with policies and are the finalisation and legalisation of policies of the State and CPC. The leadership of the CPC is provided in the Constitution of the People's Republic of China (Zhonghua renmin gongheguo xianfa) (hereinafter PRC Constitution) as one of the four cardinal principles (sixiang jiben yuanze) to be followed. The CPC delegates the job of making and implementing economic policies to the government. Due to the successful leadership of CPC, State policies are always consistent with the policies of the CPC. Analysis of FICLBS in the context of policies is helpful to understand and reveal the true intention and nature of FICLBS regime.

12 He Huahui, Renmin daibiao dahui zhidu de lilun yu shijian (The Theory and Practice of the People's Congress System) (Wuhan: Wuhan daxue chubanshe, 1992) at 265-66.

13 Peng Zhen, former Chairman of the Standing Committee of the National People's Congress, said on September 1, 1979 in a speech made at the Central Party School:

What is law? Law is the fixed form of the policies of the Party and the State, is to fix the policies of the Party and the State in the form of Law.

in Hongqi (Red Flag), 1979.11, at 16; also see Peng Zhen, Remarks Made at the Preparatory Meeting for the Third Meeting of the Sixth Session of the NPC on March 25, 1984, Liaowang (Outlook Weekly), April 8, 1985, at 19.

14 Adopted 4 December 1982 at the Fifth Session of the Fifth National People's Congress, in CCH: Business Regulation, vol. 1, supra note 1 ¶4-500.


17 Ibid. at 55-69; Albert HY Chen, An Introduction to the Legal System of the People's Republic of China (Singapore, Malaysia & Hong Kong: Butterworths Asia, 1993) at 75-76.
Chapter II of this thesis will analyse the CPC and State policies underlying the FICLBS regime.

I will argue that on one hand, China has been trying to join the world economy. As a result, China makes constant efforts to join World Trade Organisation (hereinafter WTO) and permits foreign access to Chinese domestic stock market. China also tries to establish a modern enterprise system to comply with international practice. On the other hand, China has always been trying to maintain its own characteristics. Chapter III will analyse FICLBS in the context of foreign investment law. I will argue that on one hand, FICLBS are based on the General Foreign Investment Regime. On the other hand, FICLBS demonstrate their own characteristics as distinguished from the General Foreign Investment Regime. I will address the policy reasons underlying these differences. Chapter IV will analyse the FICLBS in the context of company law. I will analyse the great influence of common law on FICLBS and the Chinese characteristics demonstrated by the FICLBS legal regime and identify policy considerations thereunder. In the last Chapter, I will make a conclusion.

In selection of the items to be compared and analysed, I try to identify those which can reveal various policies underlying FICLBS and those which are representative in the specific context of analysis. Such selection may be arbitrary and the identification may be limited by author’s knowledge and intelligence. I hope that this thesis will contribute to the understanding of FICLBS legal regime which is a new but important investment form available to foreign investors.
CHAPTER II   GENERAL POLICIES UNDERLYING THE FICLBS

I. Joining the World Economy

1. Background

The globalisation of economic activities emerged after the Second World War, particularly during the 1960s. As part of the globalisation process, the post-1960s was one of the emergence of transnational corporation (TNC) activity on the one hand and the rapid growth of international trade on the other. Subsequently, with the collapse of the Bretton Woods semi-fixed exchange rate regime in the 1971-73 period, the expansion of international securities investment and bank lending began in earnest as capital markets rapidly internationalised, adding to the complexity of international economic relations and heralding the genuine globalisation of an integrated and interdependent world economy. At present, foreign direct investment (FDI) by TNCs plays a major role in linking many national economies, building an integrated international production system -- the productive core of the globalising world economy.

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18 The term "globalisation" has been differently defined by analysts with diverse interests and perspectives. To some analysts, "globalisation" marks the hegemony of transnational capitalism in general, and the institutional primacy of the transnational corporation in particular. See S. Gill & David Law, The Global Political Economy (Hemel Hempstead: Harvester/Wheatsheaf, 1988), Chs. 7 and 11. To others, "globalisation" marks the general process of internationalization of finance, production and economic transactions. See David Held, "Democracy: From City States to a Cosmopolitan Order?" (1992) 40 Political Studies (Special Issue) 10 at 10-19.


TNCs has superseded international trade in dominating international commercial transactions.\textsuperscript{21} FDI has significant implications for the economic performance of host countries. FDI opens up prospects for additions to the capital stock, technological upgrading, skills development, and improved organisational and managerial practices simultaneously for the host countries. Hence FDI can contribute to enhancing the production capabilities and economic performance of the host countries.\textsuperscript{22} As countries increasingly recognise the importance of FDI for their development, they compete more and more to attract such investment through liberalising their FDI frameworks and creating a favourable investment climate.\textsuperscript{23} As a result, a steady increase of interdependence and openness across most of the developed and the developing worlds becomes apparent.\textsuperscript{24}

On the other hand, as a result of a number of factors including technological advances and the removal of restrictions of foreign participation by many of the world's securities markets, globalisation of securities markets is more than a developing trend, it is a present day reality.\textsuperscript{25} Many newly industrialised countries and areas such as Korea, Singapore and Taiwan have been

\textsuperscript{21} Ibid. at 3.

\textsuperscript{22} Ibid. at 188-189.

\textsuperscript{23} Ibid. at 300.

\textsuperscript{24} Hirst & Thompson, supra note 19 at 26-27.

devoted to improve and open domestic securities market in order to attract foreign securities capital. The globalisation of securities market reveals the following characteristics:

(i) The globalisation of securities market network. With the connection of SEAQ International and NASDAQ, a global securities market has formed in which securities trading is around the clock.

(ii) The globalisation of securities system of various countries. The global flow of capital has forced various countries to lessen control and open domestic securities markets to the outside world. This makes the principles, trading methods and practices of different securities markets in different countries become compatible.

(iii) The globalisation of securities issuance. The procedures of securities issuance comply with international practice. The accounting principles and listing rules for companies limited by share are unified according to the requirements of international markets. Foreign companies begin to raise capital in international securities market and list their shares on international securities exchanges. The percentage of foreign companies listed in the total number of listed companies is regarded as a criterion of the extent of the internationalisation of the securities exchange. At present, foreign companies account for about 50% of the listed companies on New York, London and other major international securities exchanges and 15% on the Asia securities exchanges.

(iv) Internationalisation of securities trading. Domestic securities companies extend to international market, bring domestic investors into international investment market and international

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investors into domestic securities markets in return. So emerged the internationalisation of the
securities trading on the secondary market.²⁷

2. Policy of joining the world economy

Although China’s leaders might not have in-depth understanding of the globalisation of
international economy, they did have an in-depth understanding of aftermath of the closed-door
(Qing Dynasty) and self-dependence (Mao Zedong) policies.²⁸ Deng Xiaoping pointed out, "[a]
closed-door policy would not help construction."²⁹ He believed that the extent of the development
of the foreign economic relationship directly affected the speed of economic construction. He
believed that, "[o]ne of the most important reasons for China’s long years of stagnation and
backwardness was its policy of closing the country to the outside contact."³⁰ Deng had a systematic

²⁷ See Li Zheng, Liu Jun & Qiu Xiaoyu, “Wuoguo zhengquan shichang guojihua wenti tantao” (Discussions on
the Internationalisation of China’s Securities Market), Caijing wenti yanjiu (Financial & Economic Issues),
February 1995, 36 at 36.

²⁸ Some observers argue that internationalization cannot explain why Deng Xiaoping and his allies decided to
initiate economic reforms in 1978. Although the trend in the international economy had over time increased the
probability that China would initiate policies to open its economy, this increase was unobservable because groups
were prevented by communist institutions from perceiving international opportunities for gain or from organizing
to gain access to them. See Susan L. Shirk, “Internationalization and China Economic Reform”, in Robert O.
Keohane & Helen V. Milner, eds., Internationalization and Domestic Politics (Cambridge: Cambridge University

²⁹ See Deng Xiaoping, “Build Socialism with Chinese Characteristics”, in Deng Xiaoping, Build Socialism with
Chinese Characteristics, trans. The Bureau for the Compilation and Translation of Works of Marx, Engels, Lenin
and Stalin Under the Central Committee of the Communist Party of China (Beijing: Foreign Language Press,
1985) 35 at 38 [hereinafter “Build Socialism with Chinese Characteristics” and Build Socialism with Chinese
Characteristics respectively].

³⁰ See Deng Xiaoping, “Achieve the Magnificent Goal of Our Four Modernisation’s and Our Basic Policies”, in
Build Socialism with Chinese Characteristics, ibid. 49 at 51.
understanding: in China's history, our ancestors suffered from the closed-door policy. Counting from the middle of Ming dynasty (1368-1644) to the Opium War (1840), the closed-door policy lasted more than 300 years. Counting from Kang Xi (1661-1722), the door had been closed for almost 200 years. As a result China fell into poverty and ignorance. After the People's Republic of China was established in 1949, although China had been open to the former Soviet Union and East Europe during the first five year plan period, for most of the time the door was still closed and the policy of closed-door was still exercised. "[W]e were blockaded by others, and so the country remained closed to some extent, which created difficulties for us." Deng Xiaoping concluded that, "our experience shows that China cannot rebuild itself with its doors closed to the outside and that it cannot develop in isolation from the rest of the world." Deng explicitly understood that the present world is an open world. In this open world, the success and failure of the economy of a country depend, to a great extent, on the level of openness and participation in the world economic competition, and on whether the country can make use of the changes of world economy. Every country or area must conduct international economic and technology exchange and co-operation in


32 Ibid.

33 See supra note 29.

34 See supra note 30.

35 See supra note 29.
order to develop social economy faster and better. Hence no country can develop with the door closed.\footnote{See “Deng Xiaoping 1984 Speech”, supra note 31 at 60-61. For a detailed discussion of the open-door policy of Deng Xiaoping, please see generally Yu Fuzhang, “Jiandingbuyi di shixing duiwai kaifang de changqi zhanlue fangzhen -- Deng Xiaoping duiwai kaifang jingji sixiang gaishu” (Firmly Adhering to the Long-term, Strategic Open Policy -- Review of Deng Xiaoping’s Economic Thinking) (1988) 72 Guoji maoyi wenti (International Trade Journal) 2.}

In their theoretical justification of opening-up, Chinese scholars point out that the founders of Marxism perceived socialist society as an open society and indeed believed that openness was a prerequisite of socialism.\footnote{Wang Lin & Leng Rong, eds., Deng Xiaoping sixiang fazhan gaishu (Summary of the Development of Deng Xiaoping Thought) (Beijing: Guofang daxue chubanshe, 1991) at 242.} As Marx and Engels said in the Manifesto of the Communist Party, "[t]he Bourgeoisie has through its exploitation of the world market given a cosmopolitan character to production and consumption in every country. ...In place of the old local and national seclusion and self-sufficiency, we have intercourse in every direction, universal inter-independence of nations. And as in material, so also in intellectual production."\footnote{See “Communist Manifesto”, in Selected Works of Karl Marx and Frederick Engels, Vol. 1 (Moscow: Foreign Languages Publishing House, 1962) 33 at 37-38.} Besides that Lenin’s advocacy of "peaceful coexistence" after the Bolshevik Revolution, and particularly economic contacts with the capitalist world are also cited as the theoretical basis for opening-up policy.\footnote{See Wang Yu et al., Deng Xiaoping jingji sixiang de yuan yuan yu fazhan (The Sources and Development of Deng Xiaoping’s Economic Thought) (Shanghai: Shanghai renmin chubanshe, 1994) at 224. For a systematic review of Marxist perspectives on interdependence and globalization, see R.J. Barry Jones, Globalization and Interdependence in the International Political Economy: Rhetoric and Reality (London: Pinter Publishers, 1995) at 23-30.}
Hence after Deng Xiaoping took power, he advocated the policy of "opening up to the outside world." After that, opening-up to the outside world was provided, as a policy of the State and the CPC, in many documents of the State and the CPC and was put in an important position. In the Report on Government’s Work of the Fourth Session of the Fifth People’s Congress made by Zhao Ziyang in 1981, opening-up to the outside world was listed as one of the ten policies of economic construction. In the Decision of the Central Committee of the CPC concerning Economic Structure Reform (Zhonggong zhongyang guanyu jingji tizhi gaige de jueding) adopted at the Third Plenum of the Twelfth General Meeting of the CPC in 1984, opening-up to the outside world was regarded as a long term Party policy and a measure of strategy to develop socialist modern construction. After three years of retreat from 1989 to 1991 due to the effect of "Tian An Men Square", the winds shifted back in January 1992 after Deng took a tour in the South China and made a series of speeches calling for broader open-door policy and acceleration of openness. At the subsequent 14th Party Congress in October 1992, open-door policy was reiterated. Since

40 The interesting thing is although after the Third Plenary Meeting of the Eleventh General Meeting of CPC in 1978 China began to adopt the policy of opening to the outside world and promulgated EJV Law in 1979, the concept of "opening-up to the outside world" began to be used in 1980. On August 21 and 23, 1980, Deng Xiaoping first used the term "opening-up to the outside world" during the meetings with Oriana Fallaci, an Italian reporter. See Deng Xiaoping, “Answers to the Italian Journalist Oriana Fallaci”, in Selected Works of Deng Xiaoping, supra note 15, 326 at 332


then, the process of openness was resumed and accelerated.\textsuperscript{43} China has been the largest developing country recipient of FDI since 1992 and the principal drive behind Asia's current investment boom.\textsuperscript{44}

China's opening-up policy has been gradually implemented according to the strategies, tactics and principles laid down by Deng Xiaoping. These consist of a multidirectional opening-up strategy, the development of economic and technical relations with foreign countries, and the establishment of economic zones and open coastal cities.\textsuperscript{45} The process of China's opening door is the process of China's economy joining the world economy.\textsuperscript{46} In terms of FICLBS, China's efforts to join the world economy can be divided into three aspects:

(1) China made constant efforts to join the General Agreement on Tariffs and Trade (hereinafter GATT) and WTO in order to establish a justified and reasonable international economic order. Because WTO has many requirements to its member States, China has to implement these requirements in China. One of these requirements which has greatest effect on FICLBS is national treatment.


\textsuperscript{45} For a detailed discussion of China's open-door policy, see Chao Chun-shan, "Peking's Policy of Opening Up to the Outside World" (1994) 30 n12 Issues & Studies 22 at 30-35.

\textsuperscript{46} See Zhu Linan, "Guo neiwei shichang jiegui yu duiwai maoyi junheng" (Combining Domestic Market with International Market and the Balance of Foreign Trade) (1994) 149 Guoji maoyi (InterTrade) 8 at 8.
(2) China is trying to join the world securities market. Permission of foreign companies to promote and establish companies limited by shares is a part of the process.

(3) China tries to establish a modern enterprise system in order to comply with international practice.

(1) **Resumption of membership of GATT and joining WTO**

After a few years practice of opening-up, China formally applied to resume its membership in GATT in 1986. Since then China has been making efforts to rejoin GATT. China's request for resumption of its GATT membership constitutes an element of its open-door policy aimed at achieving a greater degree of integration in the world economy. Chinese top leaders decided that entrance into GATT was essential to realize their economic goals. Chinese government officially states that joining WTO will help China to establish a socialist market economy and expand China's opening up.

On April 16, 1994, China signed the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations (Final Act) and the Agreement Establishing the Multilateral Trade Organisation (MTO Agreement) in Morocco, including the agreement on one of the three "new issues" placed on the negotiating agenda of the round -- Trade Related Investment

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Measures (TRIMs). If China joins WTO, the Agreement on Trade Related Investment Measures (TRIMs Agreement) will apply to China. TRIMs Agreement has nine clauses, including the following major contents:

(i) Accord national treatment to foreign investors. Prohibit those that require particular levels of local sourcing by an enterprise (i.e. local content requirements), those which restrict the volume or value of imports which an enterprise can buy or use to the volume or value of products it exports (i.e. trade-balancing requirements) and those which restrict the exportation by an enterprise of products, whether specified in terms of the particular type, volume or value of products or of a proportion of volume or value of local production.

(ii) Developing countries shall cancel their policies against the TRIMs Agreement within five (5) years after TRIMs Agreement enters into effect.

In order to join WTO, China has to take various measures to reform its economic system and adjust economic policies in order to comply with the requirements of WTO. For example, the national treatment is a guiding principle upheld by the WTO for trade relations between its signatory countries. It requires a unified policy within a country for both domestic and foreign capital to be treated as the same in taxation, law enforcement, application of regulations and

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administrative control.\textsuperscript{53} China is obliged to adopt national treatment policy for the purpose of joining WTO.\textsuperscript{54}

From the moment that China adopted open-door policy in 1979, China began to implement national treatment in some fields.\textsuperscript{55} EJV Law provides that all the activities of Sino-foreign equity joint ventures shall comply with PRC laws and regulations as domestic enterprises.\textsuperscript{56} General Principles of Civil Law (\textit{Minfa tongze})\textsuperscript{57} provides that all the civil activities conducted within China shall be subject to PRC law.\textsuperscript{58} It is further provided that as domestic enterprises, EJVs, CJVs and WFOEs established within China which meet the conditions for legal persons are entitled to obtain PRC legal person status after approval by and registration with administrations of industry and

\textsuperscript{53} See “National Treatment Comes to the Door”, in \textit{China Economic News}, 1996. 4. 1, 1 at 1.


\textsuperscript{55} See Chen Shijiang & Liu Wenwei, “Shixi wuoguo waishang touzi qiye de guomin daiyu” (Analysis of the National Treatment of Foreign Investment Enterprises in China), in \textit{Gongshang xingzheng guanli} (Administration of Industry and Commerce), 1996. 8, 38 at 38.

\textsuperscript{56} EJV Law, art. 2.

\textsuperscript{57} The General Principles of Civil Law were adopted at the Fourth Session of the Sixth National People’s Congress on April 12, 1986, in \textit{CCH: Business Regulation}, vol. 3, \textit{supra} note 1 ¶ 19-150.

\textsuperscript{58} General Principles of Civil Law, art. 8.
commerce. Civil Procedure Law (Minshi susong fa) provides that foreign investment enterprises have the same litigation rights and obligations as domestic investment enterprises.

However, the above stipulations are not systematic. From the overall point of view, the foreign investment enterprises are subject to different treatment compared with domestic investment enterprises. As a developing country practising a planned economy for as long as 40 years, to grant national treatment was out of the question when China began to introduce foreign investment. China had to resort to special administrative policies to encourage capital inflow in the absence of a sound economic and legal environment. In many respects the treatment given to foreign investment enterprises by Chinese government is more favorable than those given to domestic investment enterprises. For instance, Enterprise Income Tax Law of Foreign Investment Enterprises and Foreign Enterprises (Zhonghua renmin gongheguo waishang touzi qiye he waiguo qiye suodeshui fa) provides that the enterprise income tax for production enterprises with foreign investment whose terms exceed ten (10) years shall be exempted for the first two years after making profit and shall be reduced by 50% during the next three years. While no domestic enterprise enjoyed

59 General Principles of Civil Law, art. 41(2).
61 Civil Procedure Law, art. 5.
63 Enterprise Income Tax Law of Foreign Investment Enterprises and Foreign Enterprises, art. 8. This preferential treatment is often called "liang mian san jian" - two-year exemption and three-year reduction by foreign investors. It was initially provided as one-year exemption and two-year reduction in the Income Tax Law of the PRC Concerning Chinese-foreign Equity Joint Ventures (Zhonghua renmin gongheguo zhongwai hezi
similar tax treatment at the same time. On the other hand, China exercised strict control over foreign investment enterprises for fear of hurting domestic industries. All the foreign investment enterprises are subject to special examination and approval by MOFTEC and its authorized departments, subjecting them to below the standard national treatments. China is implementing a different treatment policy to foreign and domestic investment enterprises.

The different treatment policy raises many unsolvable problems. One of these problems is return investment (fan touzi). Return investment refers to the phenomenon that enterprises established abroad by China's domestic enterprises return to China and establish foreign investment enterprises. In theory these enterprises shall be regarded as foreign investment enterprises and

\[ jingying qiye suodeshui fa \] adopted at the Third Session of the Fifth National People's Congress on September 10, 1980, in [Zhonghua renmin gongheguo fagui huibian (Compilation of Laws and Regulations of the People's Republic of China) (January - December 1980) (Beijing: Falü chubanshe, 1981), at 13-16 [hereinafter Compilation of Laws and Regulations]. Article 5 provided that a joint venture scheduled to operate for a period of ten (10) years or more shall, upon approval by the tax authorities of an application filed by the venture, be exempted from income tax in the first profit-making year and allowed a 50% reduction in income tax in the second and third years. On September 2, 1983, the Second Meeting of the Standing Committee of the Sixth National People's Congress decided to expand the above preferential treatment to two-year exemption and three-year reduction. See Decision of the Standing Committee of the National People's Congress Regarding Revision of the Income Tax Law of the PRC for Sino-foreign Equity Joint Ventures (Quanguo renmin daibiao dahui changwu weiyouxian hu guanyu xiugai "zhonghua renmin gongheguo zhongwai hezi qiye suodeshui fa" de jueding) promulgated on September 2, 1983, in Compilation of Laws and Regulations (January - December 1983), ibid, at 115. With regard to CJVs and WFOEs, Articles 1 and 5 of the Income Tax Law of PRC for Foreign Enterprises (Zhonghua renmin gongheguo waiguo qiye suodeshui fa) which was adopted at the Fourth Session of the Fifth National People's Congress on December 13, 1981 had same provisions of two-year exemption and three-year reduction, in Compilation of Laws and Regulations (January - December 1981), ibid, at 21-25.

\[ 64 \] Article 3 of EJV Law provides that the joint venture agreements, contracts and articles of association executed between joint venture parties shall be submitted to the State foreign economic and trade departments (hereinafter referred to as the Examination and Approval Authorities) for examination and approval. The Examination and Approval Authority shall decide whether to approve within three (3) months. After approval EJVs shall be registered with the State administration of industry and commerce, obtain business license and start operation. Articles 5 and 6 of CJV Law and Articles 6 and 7 of WFOE Law have same provisions.

\[ 65 \] See Chen Shijiang & Liu Wenwei, supra note 55 at 38. Also see “National Treatment Comes to the Door”, supra note 53 at 1-2.
entitled to various preferential treatments (especially in respect of tax) enjoyed by other foreign investment enterprises. However, they are against the policy of attracting foreign investment underlying the open-door policy adopted by the Chinese central government. The main reason for the emergence of return investment is the attraction of the preferential treatments accorded to foreign investment enterprises. The same reason contributes to the emergence of false joint venture, i.e. a domestic investment enterprise find a foreign partner to form a joint venture. After obtaining a business license of foreign investment enterprise, the investments already paid by the foreign partner are drawn back and the investments subscribed and payable are no longer paid up.

In order to solve these problems, China has to accord national treatment to foreign investment enterprises.

The problem of national treatment has been apprehended by the policy making level of China. The Fifth Session of the Fourteenth National Congress of the CPC pointed out that China should use foreign investment actively, reasonably and efficiently and should accord national treatment to foreign investment enterprises gradually. By such unusual act national treatment was

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put in such a high position that the authority in charge of foreign investment -- MOFTEC is under great pressure to implement the policy of national treatment enacted by the CPC. Within a short period of time, China announced many national treatment policies. In October 1995, it was announced that Shenzhen would undergo an experiment of national treatment from 1996 to 1999 and detailed plans were released.\(^{70}\) On December 26, 1995, the State Council issued an urgent notice to cancel the import-related tax exemptions over the imported equipment within the total amount of investments of foreign investment enterprises from April 1, 1996.\(^{71}\) The Provisional Regulations on FICLBS were enacted by MOFTEC in this context. MOFTEC inevitably adopted national treatment as one of the policies underlying the Tentative Regulations on FICLBS. However, the conditions for the application of national treatment are not mature in many respects. In addition to that, MOFTEC does not seem to consider the specific context to apply national treatment. As a result, the national treatment measures formulated by MOFTEC are often simple, inflexible and do not fit in with specific contexts.

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\(^{70}\) "Shenzhen to Extend National Treatment to Foreign Business People", \textit{China Economic News}, 1995. 10. 30, 3 at 3.

\(^{71}\) See Article 2 of the Notice of the State Council Concerning Reform and Adjustment of Import Tariff Policies (\textit{Guowuyuan guanyu tiaozheng jinkou shuishou zhengce de tongzhi}) issued by the State Council on December 26, 1995 (Guo Fa No. [1995] 34), in \textit{China Laws for Foreign Business: Customs} (CCH Australia Ltd.), \textit{\textcopyright} 50 - 635 [hereinafter \textit{CCH: Customs}]. The exemption from import duties is seen as having distorted markets, encouraged "round-tripping", speculative investment and "phantom" foreign ventures. See \textit{World Investment Report 1996}, supra note 44 at xviii.
(2) Permission of foreign access to Chinese domestic stock market

China made a late start in the establishment of securities market. This is seen as an outcome of the constant need of capital for the Chinese economy. China's first two securities exchanges were established in Shanghai in 1990 and in Shenzhen in 1991 respectively. However, despite the very late start, China has been making constant efforts to join the world securities markets and achieved great progress in a short time.

In as early as 1982, China began its movement to make use of the world capital market. In January 1982, China International Trust and Investment Corporation became the first Chinese enterprise to enter the international debt bond market by issuing ¥10 billion international bond in Japan. This symbolizes the permission of Chinese government to make use of international securities market. Up to the end of 1992, the total amount of capital raised through issue of international bond had reached $6.732 billion. China gained invaluable experience and confidence in international securities market. Since then, China's efforts to join the world economy started in two directions. One is the permission of foreign access to securities market in China, the other is the foreign listing of Chinese enterprises. In March 1990, a work conference of the State

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73 See Liu Hongru, “Zhongguo zhengquan shichang de fazhan he guojihua qushi” (The Development of China’s Securities Markets and Its Internationalization Trend), Jidian ribao (Machinery and Electronics Daily), June 10, 1994, 2 at 2. Liu Hongru was the former Chairman of CSRC.


75 Liu Zhiyong, supra note 26 at 37.
Commission for Reforming the Economic Structure (Guojia jingji tizhi gaige weiyuanhui) decided that, in developing shareholding system, certain enterprises should be granted the right to sell stocks to foreign investors. In November 1991, People's Bank of China (PBOC) and the Shanghai government jointly issued regulations for B shares. Implementing Rules were promulgated later.

In November 1991, Shanghai Shenyin Securities Corporation first created the international market for China's securities by successfully issuing the first B shares for Shanghai Vacuum Electron Device Company Ltd.. B shares shall only be issued to and traded between foreign investors. They are the major form for foreign investors to make direct securities investment in China's securities markets. On February 21, 1992, Shanghai Vacuum Electron Device Company Ltd. successfully listed its B shares on Shanghai stock exchange. The issuance of B shares is the

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78 See Detailed Implementation Rules for the Measures of Shanghai Municipality for Administration of Special Renminbi-Denominated Shares (Shanghai renminbi tezhong gupiao guanli banfa shishi tiaoli) promulgated by Shanghai Branch of the People's Bank of China on November 25, 1991, in CCH: Special Zones & Cities, ibid. ¶ 91-057.


78 See Detailed Implementation Rules for the Measures of Shanghai Municipality for Administration of Special Renminbi-Denominated Shares (Shanghai renminbi tezhong gupiao guanli banfa shishi tiaoli) promulgated by Shanghai Branch of the People's Bank of China on November 25, 1991, in CCH: Special Zones & Cities, ibid. ¶ 91-057.


80 Administrative Measures of Shanghai Municipality Governing Renminbi Special Category Shares, art. 14.

81 Shanghai shehui kexueyuan (Shanghai Academy of Social Sciences), ed., Shanghai jingji nianjian 1993 (Shanghai Economic Yearbook 1993) (Shanghai: Shanghai jingji nianjian she under Shanghai shehui kexueyuan, 1993) at 428.
beginning of the integration of China's securities markets into the international market. With the listing of B shares, secondary securities markets are open to foreign investors to a limited extent. From February 21, 1992 to June 30, 1994, shares issued by 50 enterprises were listed on Shanghai and Shenzhen Securities Exchanges. Twenty-eight of them were listed on Shanghai Securities exchange with a total capitalization of $2.4 billion. Twenty-two enterprises were listed on Shenzhen Securities Exchange with a total capitalization of HK$1.3 billion.\(^\text{82}\)

Another direction is foreign listing of Chinese enterprises. Since China Huachen Jinbei Automobile Holding Company was listed on New York Stock Exchange on October 9, 1992, Chinese enterprises are listed on New York, London and Hong Kong exchanges in different ways.\(^\text{83}\)

A nation-wide securities regulatory framework also took shape. A two-tire structure was established - including both the State Council Securities Policy Committee (SCSPC) and its executive arm, the China Securities Regulatory Commission (CSRC) - and became operational in April 1993. The SCSPC consists of representatives of 14 government ministries, including the Ministry of Finance and the State Commission for Restructuring Economic System, and is primarily responsible for drafting securities laws and regulations (or authorizing the CSRC to do so) and for formulating guidelines and rules governing securities market development. The CSRC is

\(^{82}\) See Liu Zhiyong, *supra* note 26 at 40.

\(^{83}\) *Ibid.* at 37-39. These ways include direct listing and indirect listing. Direct listing refers to the listing of Chinese enterprises on overseas securities exchanges. It also includes the issue of ADR or GDR. Indirect listing refers to listing in the name of an overseas company bought or established by Chinese domestic enterprises. The main reason for this method is that China's accounting, auditing legal systems do not totally comply with international practice. Indirect listing can also serve to avoid some strict listing restrictions and procedures.
responsible primarily for implementing regulations and for supervising security firms and markets. The exchanges are entitled to set their own listing requirements and to operate as self-regulating agencies.84

All of the above paved the way for Chinese government to allow further openness of China's securities market. The promulgation of FICLBS opens China's primary securities market to foreigners to a limited extent. Although China still prohibits foreign companies to be listed directly on China's stock exchanges, permission of foreign investors to participate in China's primary securities market by establishing FICLBS is a great step forward in the process of internationalization of China's domestic Securities market.

(3) Establishment of a modern enterprise system

As China's reform continued for 16 years, many deeply hidden problems had been uncovered and some issues had become even more troublesome among which planned economy was becoming an obvious obstacle to China's further reform. The old enterprise system under which State-ownership played a leading role and no enterprise really had a real independent legal person status had been throttling the development of China's economy. In regard of foreign investment enterprises, although the three forms of them are called "companies" (gongsi) under respective laws,85 they cannot be said to be modern enterprises. A very simple and superficial

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85 EJV Law, art. 4; Implementation Regulations of CJV Law, art. 14 and Implementation Regulations of WFOE Law, art. 19.
example is that the investment in the three forms of foreign investment is computed in percentage and no shares are issued contrary to the prevailing practice in modern company law.

China's theorists have contentions over what is modern enterprise legal system. There are three major factions: Professor Wu Jinglian believes that the modern enterprise system is synonymous with the company; Mr. Hong Hu believes that the modern enterprise system does not only include the company, but also other forms; Mr. Han Zhiguo believes that the modern enterprise system refers to enterprises of legal person, the typical form of which is companies limited by shares. However, all of the three factions believe that the modern company developed in the West in recent two centuries is at least a part of the modern enterprise system.

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87 See Wu Jinglian, “Dui xiandai qiye zhidu xu zuo mingque de jiaiding” (A Clear Definition of Modern Enterprise System is Necessary), in Shichang jingji daobao (Market Economy Report), 1994. 1, at 31. He believes that the modern enterprise system mainly refers to modern companies which gradually matured in the first half of this century.

88 See Hong, Hu, “Mingque qiye gaige fangxiang jianli xiandai qiye zhidu” (Make Clear the Enterprise Reform Direction and Establish Modern Enterprise System), in Zhongguo jingji tizhi gaige (China Economic Structure Reform), 1993. 12, at 16. He believes that modern enterprise system refers to an enterprise system which conforms to social mass production, meets the needs of social market regime and in which enterprises can truly become legal person entities and market competition party in both domestic and international markets. The forms of modern enterprise system is diversified and shall not only be company. It shall include: enterprises with sole investment, partnership enterprises, contractual enterprises and company enterprises.

89 Han, Zhiguo, “Lun xiandai qiye zhidu” (Observations on Modern Enterprise System), in Gaige (Reform), 1994. 1, at 27. He believes that modern enterprise system is one in conformity with modern market economy. In modern market economy, there exist enterprises with sole investment, partnership enterprises and legal person enterprises. In the case of enterprises with sole investment and partnership enterprises, the assets of the investors are closely related to those of the enterprises and cannot be separated. Hence these two forms belongs to natural person enterprises. The so-called modern enterprise system refers to legal person enterprises rather than natural person enterprises. Companies limited by shares are a typical form of modern enterprise system.
At the end of 1993, the CPC formally adopted the policy of establishing modern enterprise system. The Decision on Some Issues Concerning the Establishment of a Socialist Market Economic Structure (Zhonggong zhongyang guanyu jianli shehui zhuyi shichang jingji tizhi ruogan wenti de jueding) made at the Third Plenary Session of the 14th Central Committee of the CPC on November 14, 1993 upholds the establishment of modern enterprise system. The decision says that modern enterprises may have various organisational patterns in which corporate form is an important one. The decision permits the establishment of companies limited by shares but restricts that they should be of a small number and must be strictly examined and approved beforehand.

Only one and a half month after the Decision, the Fifth Session of the Standing Committee of the Eighth National People's Congress passed the first company law of China on December 29, 1993. Establishment of a modern company system is listed as one of the purposes of the new PRC Company Law. The promulgation of the PRC Company Law was upheld as of great significance to establishing a modern enterprise system which is a natural requirement of the development of large-scale socialised production and market economy.

The adoption of the PRC Company Law is an integral part of China's efforts to enter world economy although China never formally acknowledges this. PRC Company Law makes the

90 Renmin ribao (People's Daily), Nov. 17, 1993, 1 at 1.
91 Ibid.
92 PRC Company Law, art. 1.
93 See Commentator of Renmin ribao (People's Daily), “Jianli xiandai qiye zhidu de zhongyao jücuo” (An Important Move to Establish Modern Enterprise System), Renmin ribao (People's Daily), Dec. 31, 1993, at 1. In China, the Commentator’s opinions in People’s Daily are generally regarded as the opinions of CPC. Also see Peter Little, “A Common Lawyer’s View of China’s Company Law” (1994) 3 Asia Pac. L. Rev. 62 at 62.
prevailing enterprise system in China similar to that in the West by drawing upon the international practice and experience with combination of Chinese characteristics. According to PRC Company Law, all the companies with foreign investment are governed by the PRC Company Law. However, in practice the new PRC Company Law has little effect on the General Foreign Investment Regime except for providing a potentiality of future development. The General Foreign Investment Regime has been developing for over fifteen (15) years and sees many conflicts with the new PRC Company Law. If the respective laws governing foreign investment enterprises are inconsistent with the PRC Company Law, these former laws shall apply. Therefore, the General Foreign Investment Regime is relatively independent of PRC Company Law. The application of PRC Company Law to foreign investment enterprises only lays the foundation of the future development of foreign investment enterprises to more advanced and modern forms. Nevertheless, the Provisional Regulations on FICLBS were enacted one (1) year after the promulgation of PRC Company Law and due to the simplicity of the Provisional Regulations on FICLBS, PRC Company Law fully applies to FICLBS.

II. The Policy of Maintaining Chinese Characteristics

94 PRC Company Law, art. 16.

95 Some Chinese scholars try to analyze how to apply PRC Company Law to foreign investment enterprises. See generally Shen Sibao, "Waishang touzi qiye shiyong gongsifa de ruogan wenti" (Several Issues Concerning Applying Company Law to Foreign Investment Enterprises), Zhongguo faxue (Jurisprudence in China) (Beijing), 1995. 1, at 47.
In contrast to opening-up and joining the world economy, China has always been trying to maintain its own Chinese characteristics. During the process of opening up and reform, the Chinese government has studied and introduced many Western ideas. However, nearly all of their reforms are labelled, "reform, with Chinese characteristics." This is the embodiment of the guideline of the CPC to construct "socialism with Chinese characteristics".

Chinese characteristics may find their theoretical roots in Mao Zedong Thought. The basic principle of Mao Zedong Thought has been lauded as "the integration of the universal truth of Marxism with the reality of China." Mao Zedong used this theory to defeat his opponent Wang Ming who had studied in Soviet Union and insisted on copying the revolution model of Soviet Union in the 1930's. Mao insisted that all shall start from and be based on the actual circumstances instead of emulating the model of others without analysis. Mao's thought is best summarised in his famous article "On the Ten Major Relationships" in which he said, “[o]ur policy is to learn from the strong points of all nations and all countries, learn all that is genuinely good in the political, economic, scientific and technological fields and in literature and art. But we must learn with an analytical and critical eye, not blindly, and we must not copy everything indiscriminately and translate mechanically." Deng Xiaoping used similar theory to


97 Deng Xiaoping, “Build Socialism with Chinese Characteristics”, supra note 29 at 35.

98 Tang Tsou, Ershi shiji zhongguo zhengzhi (Twentieth Century Chinese Politics) (Hong Kong: Oxford University Press, 1994) at 73-82.

defeat his opponent Hua Guofeng in 1978 and established the guiding policy of starting from actual circumstances. Socialism with Chinese characteristics is the development of the same principle.

The theory of Chinese characteristics first appeared in 1982. In the Opening Speech at the Twelfth National Congress of the CPC, Deng Xiaoping put forward the theory of constructing "socialism with Chinese characteristics". This was soon adopted as a policy and was put in a guiding position. The theory is elevated to a par with Mao Zedong Thought which was said to have served China at an earlier time and will guide the opening-up and reform efforts. The term "Chinese characteristics" has been widely used ever since together with opening-up and reform.

Generally, Chinese characteristics mean starting from or based on the actual circumstances of China. However, no exact definition is given and one may find it difficult to identify those Chinese characteristics. Some models are suggested to systematically analyse Chinese characteristics. For example, the famous Suzanne Ogden's model of three basic competing Chinese values— traditional Chinese culture, socialism (ideological and political variables) and

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100 Hua Guofeng, the hand-picked successor to Mao Zedong, advocated that what Mao said was always right and what Mao did was always right. This is called "two whatevers" (liangge fanshi) theory. Deng Xiaoping, on the contrary, contended against the blind copy of Mao's theory, advocated that practice was the only criteria for testing a truth. See Roderick MacFarquhar, "The Succession to Mao and the End of Maoism, 1962-82" in Roderick MacFarquhar, ed., The Politics of China 1949-1989 (Cambridge: Cambridge University Press, 1993) 248 at 317-18.


103 See Suzanne Ogden, China’s Unresolved Issues: Politics, Development and Culture, 3d ed. (Englewood Cliffs, NJ: Prentice-Hall, 1995) at 6-9. Suzanne Ogden argues that these three basic competing values underlie all the policies of the Chinese government. Changes of these policies reflect the changes of priority of these values.
development -- are used by some scholars as a framework to examine Chinese characteristics. However, no model is perfect and can cover all the aspects of such a complicated subject. Chinese characteristics embodied in the FICLBS regime are very complicated. Historical, cultural, economic and legal factors may all find their effects on these Chinese characteristics. We have to analyse them case by case.

One of the most striking Chinese characteristics in the FICLBS legal regime is strict State control. China's foreign investment legal regime is based on a regulatory ethic that posits the State as the primary agent for economic and social development. When China first adopted open door policy and began to establish foreign investment legal regime by enacting EJV Law in 1979, the Chinese government made clear its intent to supervise foreign investment and business activities closely. State control constitutes one of the policies underlying the foreign investment legal regime and has never been changed.

The policy of State control in foreign investment legal regime has significant historical and social reasons. After the establishment of the PRC, Mao Zedong insisted on the leading role of the CPC in the administration of China. Mao believed that the leading role of the CPC should be so absolute that the CPC should be above the NPC and the State Council in the administration of China.

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104 See generally, Aufrecht & Li, supra note 96. In this article, Steven E. Aufrecht & Li Siu Bun analyze the Chinese characteristics of China's civil service system on the basis of Ogden model.


106 Ibid. at 167-68.

China's economy. In fact, the CPC was regarded as the government at that time. After Mao, Deng Xiaoping rose as China's top leader. Deng and his followers began a process of strengthening China's legal structure and creating a new "socialist legal system with Chinese characteristics". State control of national economy was upheld as the basic ethics of the socialist legal system. This belief is so firm that in the Constitution of PRC promulgated in 1982, it was provided that it was an obligation of the State to practise State control over the economy. With the lapse of time, although China adopted socialist market economy in 1993, the State's function as an agent for economic development is not diluted. Many Chinese legal theorists believe that economic law is the product of State intervention in the economy. The most important characteristics of economic law is the State intervention in the economy. The adjusting objects of the economic law are those economic relations which need the intervention and adjustment of the State. The purpose of the economic law is to ensure the realization of the greatest interest of the State intervention in the economic activities.

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109 Supra note 14.

110 Article 15 of the PRC Constitution provides that the State shall ensure the proportionate and co-ordinated growth of the national economy through overall balancing by economic planning and the supplementary role of regulation by the market.


The social reasons also account for the adoption of State control over foreign investment legal regime. Foreign investment legal regime started to be established at the same time as China's overall legal regime. In 1979, the government enacted a criminal code, a code of criminal procedures and five other major laws one of which is the EJV Law.\(^\text{113}\) This is the beginning of establishment of an overall legal regime in China. The controlling economy was still a planned economy at that time in which the State played a major role. Under the planned economy, State control naturally became one of the basic ethics of the then current legislation. This inevitably affected the legislation of foreign investment. At that time, China just adopted open door policy and knew little about the outside world. During the process of reversing the policy of strict control of foreign access to Chinese market, China has many concerns. In order to ensure that foreign investment does not constitute a menace to the leading role of planned economy, China adopts the policy of separating the foreign investment legal regime from the domestic legal regime, and exerts State control over the separate foreign investment legal regime.

\(^{113}\) All these laws were fundamental laws for the purpose of establishing a new legal system. These laws are: Organic Law of Local People’s Congresses and Local People’s Governments of the PRC (Zhonghua renmin gongheguo difang geji renmin daibiao dahui he difang geji renmin zhengfu zuzhi fa) adopted at the Second Session of the Fifth National People’s Congress on July 1, 1979, in Compilation of Laws and Regulations (January-December 1979 ), supra note 63 at 4; Electoral Law of the National People’s Congress and Local People’s Congresses of the PRC (Zhonghua renmin gongheguo Quanguo renmin daibiao dahui he difang geji renmin daibiao dahui xuanji fa) adopted at the Second Session of the Fifth National People’s Congress on July 1, 1979, in Compilation of Laws and Regulations (January-December 1979 ), supra note 63 at 18; Organic Law of the People’s Courts of the PRC (Zhonghua renmin gongheguo renmin fayuan zuzhi fa) adopted at the Second Session of the Fifth National People’s Congress on July 1, 1979, in Compilation of Laws and Regulations (January-December 1979 ), supra note 63 at 29; Organic Law of the People’s Procuratorates of the PRC (Zhonghua renmin gongheguo renmin jianchayuan zuzhi fa) adopted at the Second Session of the Fifth National People’s Congress on July 1, 1979, in Compilation of Laws and Regulations (January-December 1979 ), supra note 63 at 40; Criminal Law of the PRC (Zhonghua renmin gongheguo xingfa) adopted at the Second Session of the Fifth National People’s Congress on July 1, 1979, in Compilation of Laws and Regulations (January-December 1979 ), supra note 63 at 48; and Criminal Procedure Law of the PRC (Zhonghua renmin gongheguo xingshi susongfa) adopted at the Second Session of the Fifth National People’s Congress on July 1, 1979, in Compilation of Laws and Regulations (January-December 1979 ), supra note 63 at 87.
III. Summary

The policies underlying FICLBS seem to contradict each other. On one hand, China determines to keep on its opening up policy and makes constant efforts to join the world economy. On the other hand, as one of the last socialist countries, China has always been trying to maintain its own Chinese characteristics. These policies account for the promulgation of Provisional Regulations on FICLBS and constitute the basis of FICLBS. However, the process of China’s opening up and economic reform is still unfolding and it is unclear where the process will go and with what result.\textsuperscript{114} The possible change in Party and State policies will inevitably affect FICLBS legal regime.

CHAPTER III FICLBS AS A FORM OF FOREIGN INVESTMENT

I. FICLBS are based on the General Foreign Investment Regime

Provisional Regulations on FICLBS expressly provide that FICLBS are a form of foreign investment enterprises and shall be governed by the relevant legal provisions concerning foreign investment enterprises. Unfortunately, no detailed rules are given to define "the relevant legal provisions concerning foreign investment enterprises." Nor do any rules be given to explain how "the relevant legal provisions" are applied to FICLBS.

1. How to apply foreign investment provisions to FICLBS

Generally foreign investment enterprises refer to EJVs, CJVs and WFOEs. China's foreign investment legal regime centres on separate laws and regulations addressing separate forms of foreign investment (i.e., EJV Law, CJV Law, WFOE Law and their Implementation Regulations), complemented by various separate administrative legislations. Such complementary administrative legislations are also addressed to respective forms of foreign investment at the beginning of China's opening up. For example, Income Tax Law of Sino-foreign Equity Joint Ventures, Provisions Concerning Supervision, Levy and Exemption of Tariffs on Goods Imported and Exported by Sino-foreign Contractual Joint Ventures (Guanyu zhongwai hezuo jingying qiye

115 See Provisional Regulations on FICLBS, art. 3.

116 Lu Jongxing, supra note 54 at 76.
are addressed to EJVs and CJVs respectively. The turning point came on October 11, 1986 when the State Council promulgated Provisions Concerning the Encouragement of Foreign Investment (Guowuyuan guanyu guli waishang touzi de guiding). In these Provisions the concept of “foreign investment enterprises” (waishang touzi qiye) was first used to refer to EJV, CJV and WFOE. In order to implement Provisions Concerning the Encouragement of Foreign Investment, the State Administration of Industry and Commerce (SAIC), General Office of Customs, PBOC, Ministry of Labour and Personnel, MOFERT and Ministry of Finance enacted a series of administrative rules. Subsequently, the NPC integrated the tax system of foreign investment enterprises by promulgation of Income Tax Law for Foreign Investment Enterprises and Foreign Enterprises which repealed the Income Tax Law of PRC for Sino-foreign Equity Joint Ventures and Income Tax Law of PRC for Foreign Enterprises. The Income Tax Law for Foreign Investment Enterprises and Foreign

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117 Promulgated by The General Office of Customs, the Ministry of Finance and MOFERT on January 31, 1984, in Compilation of Laws and Regulations (January-December 1984), supra note 63 at 393.


119 Provisions Concerning the Encouragement of Foreign Investment, art. 2.

120 See Lu Jongxing, supra note 54 at 76-77. For example, Regulations on the Right of Autonomy of Foreign Investment Enterprises in the Hiring of Personnel and on Employees’ Wages, Insurance and Welfare Expenses (Guanyu waishang touzi qiye yongren zizhuquan he zhigong gongzi, baoxian, fuli feiyong de guiding) promulgated by the Ministry of Labour and Personnel on Nov. 10, 1986, in CCH: Business Regulation, vol. 2 supra note 1 ¶ 12-590. At the beginning of these Regulations it is expressly provided that “[t]hese Regulations are formulated in order to implement the State Council Regulations concerning Encouragement of Foreign Investment.”

121 See Income Tax Law for Foreign Investment Enterprises and Foreign Enterprises, art. 30.
Enterprises confirms the general definition of foreign investment enterprises. An integrated foreign investment legal regime was formed.

When we try to determine whether a provision of foreign investment enterprises shall apply to FICLBS, the time of the enactment of such provision is of great significance. Before the Provisional Regulations on FICLBS were promulgated, FICLBS are not allowed to be established under the PRC law. Many provisions simply fail to consider this possibility. They deserve more consideration in determining whether they shall apply to FICLBS. While those provisions made after the promulgation of Provisional Regulations on FICLBS can be reasonably assumed to have considered FICLBS. So different rules shall be applied in determining which rules of foreign investment apply to FICLBS.

1.1 **Provisions promulgated after the Provisional Regulations on FICLBS.**

Based on the above assumption, we propose that only the provisions expressly refer to foreign investment enterprises or foreign investment shall be applied to FICLBS. Those referring to EJV, CJV and WFOE or three forms of foreign investment enterprises (sanzi qiye) shall not apply to FICLBS. This is because FICLBS are the fourth form of foreign investment. They are different from EJVs, CJVs and WFOEs.\(^{123}\)

\(^{122}\) Article 2 of the Income Tax Law for Foreign Investment Enterprises and Foreign Enterprises provides that foreign investment enterprises refer to EJVs, CJVs and WFOEs.

\(^{123}\) See *supra* notes 7-11 and accompanying text.
However, not all the provisions relating to foreign investment enterprises apply to FICLBS. There are dangerous exceptions. In the title of the Liquidation Methods for Foreign Investment Enterprises (hereinafter referred to as Liquidation Methods) promulgated by MOFTEC on July 9, 1996, foreign investment enterprises refer to EJVs, CJVs and WFOEs. These methods were promulgated after Provisional Regulations on FICLBS were promulgated on January 10, 1995. Therefore, these methods shall not apply to FICLBS based on our previous conclusion that FICLBS are a fourth form of foreign investment. The liquidation of FICLBS has to be handled according to the PRC Company Law.

1.2 Provisions promulgated before the Provisional Regulations on FICLBS.

Provisions relating to foreign investment enterprises promulgated before the Provisional Regulations on FICLBS can be divided into two categories. One is those provisions applying to the General Foreign Investment Regime, i.e. EJV, CJV and WFOE. The other is those provisions applying only to EJV and CJV. We propose the following rules:

(i) Those relating to foreign investment enterprises or CJVs, EJVs and WFOEs shall apply to FICLBS. For example, Income Tax Law for Foreign Investment Enterprises and Foreign Enterprises applies to EJVs, CJVs and WFOEs. There is no legislative reason to prevent FICLBS

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125 See Liquidation Methods for Foreign Investment Enterprises, art. 2.

126 Article 25 of the Provisional Regulations on FICLBS provides that issues of FICLBS not covered in these Tentative Regulations shall be handled according to PRC Company Law and other relevant provisions.
from being governed by Income Tax Law for Foreign Investment Enterprises and Foreign Enterprises and enjoying the preferential treatments. For such purposes, one can reasonably conclude that the reference to the three forms of foreign investment enterprises before the promulgation of Tentative Regulation on FICLBS should be automatically amplified and include FICLBS. This can be set up as a rule to define what is foreign investment enterprises.

(ii) Shall the foreign investment regime applying only to EJVs and CJVs have binding force on FICLBS? Legal provisions only governing EJVs and CJVs shall not be regarded as "the relevant legal provisions concerning foreign investment enterprises" referred to in Article 3 of the Provisional Regulations on FICLBS because they do not govern WOFEs. They are not supposed to cover all the foreign investment enterprises. However, this does not mean that these provisions do not necessarily apply to FICLBS. There are exceptions.

There exist similarities between EJV, CJV and FICLBS in that all of them involve Chinese partners, i.e. all of them are joint ventures. Hence where the basis of or reason for the provisions is an issue on which EJVs, CJVs and FICLBS bear similarity, these provisions shall apply to FICLBS. For instance, China permits foreign investors to establish EJVs or CJVs to engage in advertising. We cannot certainly conclude whether FICLBS are also permitted to carry on advertising. While in the case of Audit Methods for Sino-foreign Equity and Contractual Joint

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127 See Article 2, Several Provisions concerning the Establishment of Foreign Investment Advertising Enterprises (Guanyu sheli waishang touzi guanggao qiye de ruogan guiding) jointly issued by SAIC and MOFTEC on November 3, 1994 (Gong Shang Guan Zi [1994] No. 304) (copy on file with the author).
Ventures (Zhongwai hezi hezuo jingying qiye shenji banfa),\textsuperscript{128} the purpose of these Methods is to ensure the maintaining and increase of State-owned assets. FICLBS involve Chinese partners as well, so the extent of need to strengthen State-owned assets administration is the same as in EJVs and CJVs. The Audit Methods for Sino-foreign Equity and Contractual Joint Venture shall therefore apply to FICLBS.

1.3 Provisions emphasising the characteristic of limited liability companies

Those provisions governing foreign investment enterprises as limited liability companies should not apply to FICLBS no matter when these provisions are enacted. PRC Company Law divides companies into limited companies and companies limited by shares.\textsuperscript{129} All the EJVs, CJVs and WFOEs are generally limited liability companies, different from FICLBS. This is the basic distinction between FICLBS and other three forms of foreign investment enterprises. So any legal provision concerning foreign investment that emphasises the characteristic of the foreign investment companies they govern as limited liability companies shall not apply to FICLBS. For example, can FICLBS be a holding company? The Tentative Regulations on Foreign Investment Holding Companies (Guanyu waishang touzi juban touzixing gongsi de zanxing guiding) specifically provide

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\textsuperscript{128} These Methods were promulgated by the State Audit Office on January 12, 1993, in Zhonghua renmin gongheguo falü fagui quanshu (Encyclopaedia of Laws and Regulations of PRC), vol. 5 (Beijing: Zhongguo minzhu fazhi chubanshe, 1994) 947 [hereinafter Encyclopaedia of Laws and Regulations].

\textsuperscript{129} See PRC Company Law, arts. 2 and 3.
\end{flushright}
that such companies shall be in the form of limited liability companies. Such specific provision can only be construed as prohibiting foreign investment holding companies to be FICLBS.

All of the above rules are not able to thoroughly solve the problems created by Article 3 of the Provisional Regulations on FICLBS. Many issues still remain unclear.

2. **Scope of FICLBS**

FICLBS, as a form of foreign investment companies, exclude a kind of companies which meet almost all the requirements in the definition of FICLBS except for foreign promoters. Article 6 of the Provisional Regulations on FICLBS requires that the promoters of FICLBS shall include at least one foreign investor. Many of the domestic companies limited by shares established under PRC Company Law or its previous counterparts whose foreign share capital exceeds 25% of the total share capital through the issue of B shares in the domestic stock market and H (in Hong Kong) and N (in New York) shares in foreign capital markets are not regarded as FICLBS according to

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131 Before the promulgation of PRC Company Law, Regulating Opinions on Companies Limited by Shares (*Gufen youxian gongsi guifan yijian*) and Regulating Opinions on Limited Liability Companies (*Youxian zeren gongsi guifan yijian*) promulgated by the State Commission for Restructuring Economic System on May 15, 1992 were regarded as provisional company laws in the shareholding experiment beginning from 1992. They can be found in Guowuyuan fazhiju (The Legal Bureau of the State Council), ed., *Zhonghua renmin gongheguo xin fagui huibian 1992 di er ji* (Compilation of New Law and Regulations of the PRC 1992 vol. 2), (Beijing: Zhongguo fazhi chubanshe, 1994) 199 and 234 respectively [hereinafter *Compilation of New Laws and Regulations*].
Article 6 of the Provisional Regulations on FICLBS because they do not have foreign promoters. Articles 21 to 23 of Provisional Regulations on FICLBS try to solve this problem by setting forth the procedures and requirements of transforming such companies into FICLBS. The attitude adopted by the Provisional Regulations on FICLBS (hence that of MOFTEC) does not acknowledge that these companies automatically become FICLBS. They must apply to MOFTEC and only after the grant of approval by MOFTEC and completion of a set of procedures can they transform into FICLBS. Before that, they should not be regarded as FICLBS. Hence in determining whether a company is a FICLBS not only the share structure is considered, historical factors are also considered. That is to say at least one foreign promoter is a part of the criteria of FICLBS, unless otherwise approved by the MOFTEC. Any company which issues foreign capital shares is subject to the strict State control by SCSPC and CSRC. Before issuing foreign capital shares, an approval of SCSPC shall be obtained. Why does MOFTEC require the additional approval for these companies to become FICLBS? Is this double approval system necessary?

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132 Article 6 of the Provisional Regulations on FICLBS provides that no matter the FICLBS are established through promotion or floating, they shall have at least one foreign promoter.

133 See Provisional Regulations on FICLBS, arts. 20-23.


135 Special Regulations of the State Council Concerning Floating and Listing of Shares Overseas by Companies Limited by Shares, art. 10; Regulations of the State Council on Foreign Capital Shares Listed in China by Companies Limited by Shares, art. 5.
The double approval system can be justified by the need to distinguish foreign investment companies from ordinary domestic companies. Provisional Regulations on FICLBS do not mandate that all such companies shall apply to convert themselves into FICLBS. Theoretically, they have the discretion to choose whether to convert into FICLBS. Furthermore, the application for conversion does not guarantee that MOFTEC will grant approval. In the case that such companies do not apply or fail to convert into FICLBS, can they be regarded as foreign investment enterprises? This problem exists long before the promulgation of the Provisional Regulations on FICLBS. After permitting selected domestic companies (mainly large State owned companies) which were undergoing shareholding experiment to issue B, H and N shares, the problem of whether the above described companies are regarded as foreign investment enterprises began to emerge. Other ministries and departments also addressed this problem in their legislations before or after the promulgation of the Provisional Regulations on FICLBS by providing whether they are foreign investment enterprise. Different ministries and departments relating to the administration of foreign investment in PRC adopted similar views on this problem. CSRC and State Administration of Exchange Control (hereinafter SAEC) issued a joint notice on January 13, 1994 (before the Provisional Regulations on FICLBS were promulgated).\footnote{Notice Concerning Relevant Questions on the Foreign Exchange Administration of Enterprises Listed Overseas (Guanyu jingwai shangshi qiye waihui guanli youguan wenti de tongzhi) (zheng jian fa zi [1994] No. 8) (copy on file with the author).} According to this notice, a domestic enterprise which issues shares overseas if the foreign exchange capital amounts to or exceeds 25% of the total amount of net assets of the enterprise, may according to the provisions of EJV Law apply to MOFTEC and other departments authorised by MOFTEC and go through relevant
procedures of EJVs. After approval, it can become an EJV and its issues relating to foreign exchange shall be administered as a foreign investment enterprise. On July 19, 1995 (after the Provisional Regulations on FICLBS were promulgated) SAIC issued Opinions on Relevant Issues concerning the Implementation of Administrative Laws and Regulations on Company Registration Applicable to Foreign Investment Enterprises (Guanyu waishang touzi qiye dengji guanli shiyong gongsi dengji guanli fagui youguan wenti de zhixing yijian) under which a company limited by shares listed overseas after approval with foreign investment in excess of 25% of the company’s shares will be regarded as a foreign investment enterprise after the approval by the Examination and Approval Authority and issue of an approval certificate thereafter.

In order to exclude the companies described above, the definition of FICLBS will add: at least one of its promoters shall be a foreign investor, unless otherwise be approved by MOFTEC.

II. Characteristics of FICLBS - a product of Party and State policies.

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137 Notice Concerning Relevant Questions on the Foreign Exchange Administration of Enterprises Listed Overseas, art. 4.

Due to the policies underlying the FICLBS legal regime, FICLBS demonstrate some characteristics different from the general foreign investment enterprises. In this section, we will identify these differences and reveal the policies that account for these differences.

1. **Scope of Investors**

There is a significant development from EJV and CJV to FICLBS in terms of the scope of the investors. Comparison between them reveals that the permitted scopes of foreign investors of the three forms of foreign investment are the same: foreign companies and/or enterprises, other economic organisations or individuals. The scopes of Chinese investors are also the same: Chinese companies, enterprises and other economic organisations. Such provision is a quotation from the PRC Constitution. Apparently, individuals are prohibited from acting as Chinese partners in EJVs, CJVs and FICLBS. Furthermore, MOFTEC and SAIC specify that the Chinese partners for EJVs and CJVs shall be enterprise legal persons or other economic organisations who are legal persons as defined in the General Principles of Civil Law. All non-legal persons are strictly prohibited from participation in joint ventures. Although MOFTEC and SAIC make exceptions

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139 See Provisional Regulations on FICLBS, art. 1; EJV Law, art. 1; and CJV Law, art. 1.

140 See Zheng Yanzhuo et al., Zhongguo yanhai kaifang chengshi liyong waizi falti wenti (Legal Issues Concerning Using Foreign Investment in Coastal Opening Cities in China) (Shanghai: Shanghai Social Academy Press, 1994) at 37. Article 18(1) of the PRC Constitution provides that the People's Republic of China permits foreign enterprises, other foreign economic organizations and individual foreigners to invest in China and to enter into various forms of economic cooperation with Chinese enterprises and other economic organizations in accordance with the law of the People's Republic of China.

141 See Notice Concerning Strengthening the Examination and Approval of the Legal Person Status of Chinese Partners in Sino-foreign Equity Joint Ventures (Guanyu yange shenhe jtiban zhongwai hezi jingying qiye...
-- urban and rural individual industrial and commercial households (chengxiang geti gongshang hu), citizens engaged in industry and commerce through contracts (chengbao gongshangyie jingying de gongmin) and individual partnerships (geren hehuo), they can only be allowed to participate in joint ventures subject to special approval.142 Some observers argue that under PRC Constitution, these businesses are limited to “individual businesses of urban and country working people” (chengxiang laodongzhe geti jingji),143 thus exclude the possibility of individuals to take part in foreign investment enterprises.144 No provisions are found to address whether the above rules apply to FICLBS.

In China, Individual Industrial and Commercial Households, Rural Contracting Households and Individual Partnerships are legal concepts different from both legal persons and citizens although they are provided in the General Principles of Civil Law under the heading of Citizens (natural person).145 Individual Industrial and Commercial Households refer to individual citizens or households engaged in industrial and commercial operations within the scope permitted by law after examination and approval, with their individual assets or family assets as operation capital.146

zhongfang faren zige de tongzhi ) jointly issued by MOFTEC and SAIC on September 21, 1987, in Encyclopaedia of Laws and Regulations, vol. 8, supra note 128 at 105, art. 1.

142 Ibid. art. 4.

143 PRC Constitution, art. 11.

144 See Zheng Yanzhuo et al., supra note 140 at 37.


146 Tong Rou et al., Zhongguo minfaxue • minfa zongze (China’s Civil Law • General Principles of Civil Law) (Beijing: Zhongguo renmin gongan daxue chubanshe, 1990) at 135. Also see General Principles of Civil Law, art. 26.
Rural Contracting Households refer to the members of the rural collective organisations who are engaged in commodity operation through contract within the scope permitted by law.\textsuperscript{147} Individual partnership refers to the act or organisation of two or more persons who provide investment as agreed for the purpose of operate their common businesses.\textsuperscript{148} Individual businesses have developed quickly and dramatically during the past two decades with the deepening of reform and the development of China's economy. Up to the end of 1994, the number of people engaged in individual business nation-wide reached 37,759,000, and 21,866,000 in terms of households.\textsuperscript{149} Individual businesses have become active participants in China's economy. The businesses of them have been expanded from the third line of industry to production, manufacture, real estate, high technology businesses. The need of them to raise their production capacity and expand their operation scale accounts for their urgent need of foreign capital and technology.\textsuperscript{150}

On the other hand, with the development of China's economy, the balance of personal savings of both urban and rural Chinese residents (\textit{chengxiang jumin chuxu cunkuan yu'e}) had reached RMB3.79 trillion by the end of November 1996.\textsuperscript{151} This is a very large amount of capital

\textsuperscript{147} General Principles of Civil Law, art. 27. Also see Tong Rou et al., \textit{ibid}. at 137.

\textsuperscript{148} General Principles of Civil Law, art. 30. Also see Tong Rou et al., \textit{ibid}. at 139.


in whatever sense. The good prospect of profitability of FICLBS will surely attract these capitals. These capitals will become a large resource for FICLBS in turn in the case that individuals are entitled to participate in FICLBS.

Individuals and individual businesses can participate in FICLBS based on the following three levels of analysis:

(i) FICLBS may adopt the means of public issue to be established.\(^{152}\) Where FICLBS are established by means of public issue, the remaining shares after subscription by promoters shall be made available to the general public for subscription.\(^{153}\) Hence in the process of establishment of FICLBS, individuals, individual businesses and other economic forms of non-legal person are entitled to participate in FICLBS through the subscription of the shares of the FICLBS.

(ii) In order for FICLBS to be listed on a stock market, shares issued to the general public must account for more than twenty-five percent (25\%) of the total share issue. Where FICLBS have registered capital of more than RMB400 million, shares issued to the general public must account for at least fifteen percent (15\%) of the total share capital.\(^{154}\) Hence in the case that FICLBS intend to become listed companies, they have to issue shares to the general public.

(iii) The PRC Company Law provides that the shares held by shareholders may be transferred according to law.\(^{155}\) However, no legal provision is found to prohibit shares to be...

\(^{152}\) Provisional Regulations on FICLBS, art. 1.

\(^{153}\) See PRC Company Law, art. 83.

\(^{154}\) See PRC Company Law, art. 152(4).

\(^{155}\) PRC Company Law, art. 143.
transferred to individuals. In the case of listed FICLBS, it is impossible to prohibit individuals to trade shares of FICLBS on the stock markets.

In summary, it is impossible to exclude individuals, individual businesses and other non-legal person economic organisations from participating in FICLBS.

The scope of investors of FICLBS is a product of foreign access to the Chinese domestic stock markets. This gives foreign investors the opportunity to diversify their investments in China. In the meantime, it gives foreign investors more ways to get out of FICLBS. This is of great significance considering liquidation is difficult now in China. Foreign investors may through selling their shares on the stock markets get out of FICLBS.

2. Land Use Right - Three Rails Regime

In China two major forms of obtaining land both for domestic and foreign investment enterprises are granting and allocation. Land belongs to the State or is collectively owned by working people.\textsuperscript{156} With regard to urban land in which most of the foreign investment enterprises are located, the State, in accordance with the principle of separating the ownership of land from the right to use land, implements a system of the grant and allocation of the right to use State owned land.\textsuperscript{157} Granted land use right means that the State, in its capacity as land owner, grants the right

\textsuperscript{156} Law of the PRC on Land Administration (Zhonghua renmin gongheguo tudi guanli fa) adopted at the Sixteenth Session of the Standing Committee of the Sixth NPC on June 25, 1986, in CCH: Business Regulation, vol. 2, supra note 1 ¶ 14-716, art. 2.

\textsuperscript{157} Provisional Regulations of PRC Concerning the Grant and Transfer of the Right to Use State Owned Land in Urban Areas (Zhonghua renmin gongheguo chengzhen guoyou tudi shiyongquan churang he zhuanrang zanxing tiaoli) promulgated by the State Council on 24 May 1990, in CCH: Business Regulation, vol. 2, supra note 1 ¶ 14-716, arts. 8 and 43 (hereinafter 1990 Urban Land Regulations).
to use land for a certain number of years to a land user and the land user pays to the State a fee for the grant of land use right. The consideration for such land use right and the land use conditions shall be specified in a land use right granting contract signed between the State and land users.\textsuperscript{158} The considerations will be paid within 60 days after the execution of the land use right granting contract.\textsuperscript{159} Upon full payment of the consideration, a land use certificate will be issued by the State land administration departments.\textsuperscript{160} The maximum terms for granted land use rights are fifty (50) years in the case of land for industrial purposes.\textsuperscript{161} Allocated land use rights refer to land use rights lawfully acquired without consideration by land users from the State.\textsuperscript{162} There is no time limit for allocated land use rights. FICLBS can also obtain land use rights through these two forms. In fact these are the only two forms through which domestic enterprises can obtain land use rights. As for foreign investment enterprises, there is an additional way to obtain land use right which is called the site use rights.\textsuperscript{163} Well before the 1990 Urban Land Regulations, according to the EJV Law of 1979, EJVs could obtain land use rights directly from the State in the form of site use right and could pay site use fees annually during the land use term. These fees were equivalent

\textsuperscript{158} 1990 Urban Land Regulations, art. 8.
\textsuperscript{159} 1990 Urban Land Regulations, art. 14.
\textsuperscript{160} 1990 Urban Land Regulations, art. 16.
\textsuperscript{161} 1990 Urban Land Regulations, art. 12.
\textsuperscript{162} 1990 Urban Land Regulations, art. 43.
in amount to the land use fee now applied in cases of land use right granting.\textsuperscript{164} Although this site use fee is stipulated in the EJV Law, it has been expanded to all other foreign investment enterprises.\textsuperscript{165} This expansion has been confirmed by many State regulations and notices. State authorities have been calling upon local authorities to strengthen the administration of the site use fee collected from the foreign investment enterprises according to this method. The Ministry of Finance and the State Land Administration Bureau issued a notice on collecting site use fee from foreign investment enterprises in 1995.\textsuperscript{166} According to this notice, the government finance departments at different levels shall establish a special account for site use fee collected from foreign investment enterprises which shall be exclusively used for saving and settlement of site use fee.\textsuperscript{167} The site use rights constitute the third way for foreign investment enterprises to obtain land use rights in addition to the allocation and granting as provided in the 1990 Urban Land Regulations. They are called "two rails" land system (\textit{shuang gui zhi}).\textsuperscript{168} As a form of foreign investment, FICLBS shall also be entitled to the site use rights. Site use rights enable FICLBS to

\textsuperscript{164} EJV Law, art. 5; Implementation Regulations of EJV Law, arts. 47-53.

\textsuperscript{165} Nan Luming & Xiao Zhiyue, \textit{supra} note 163 at 231.

\textsuperscript{166} Notice Concerning Strengthening the Administration of Collecting Site Use Fee from Foreign Investment Enterprises (\textit{Guanyu jiaqiang waishang touzi qiye changdi shiyongfei zhengshou guanli de tongzhi}) jointly issued by the Ministry of Finance and the State Land Administration Bureau on March 15, 1995, in \textit{Beijing fangdichan zazhi} (Beijing Real Estate Journal), 1995. 10, at 17.

\textsuperscript{167} Notice Concerning Strengthening the Administration of Collecting Site Use Fee from Foreign Investment Enterprises, art. 1.

\textsuperscript{168} See Minutes of a Meeting on the Land Use Administration of Foreign Investment Enterprises” (\textit{Waishang touzi qiye yongdi guanli gongzuozuotanhui jiyao}) issued by the State Land Administration Bureau on December 31, 1990 (copy on file with the author).
pay the land use fees throughout their entire land use terms instead of within 60 days after obtaining land use rights in the case of granting.

There is another form of obtaining land use right directly from the State unique to companies limited by shares. The Tentative Regulations on the Administration of Land Use Rights for Companies Limited by Shares (Gufen youxian gongsi tudi shiyongquan guanli zanxing guiding) issued by the State Commission for Restructuring Economic System and the State Land Administration Bureau grant companies limited by shares another way — leasing land from the State.\(^{169}\) Under these Regulations, the State may lease land use rights to companies limited by shares and shall collect rent periodically.\(^{170}\) There is no reason to object to the application of these regulations to FICLBS. Hence this provides the fourth way for FICLBS to obtain land use rights. Unfortunately, both the additional way for foreign investment enterprises and the additional way for companies limited by shares are inconsistent with the land granting and allocation regime. Thus FICLBS have a unique three-rail land use right system.

Three-rail system derives from the policy of national treatment. It makes all the land use right obtaining forms available to foreign and domestic investment enterprises applicable to FICLBS. MOFTEC did not make specific analysis and simply put FICLBS in a position to enjoy all the treatments of domestic enterprises. In fact, the conditions for national treatment are not mature. The availability of the lease form to FICLBS creates many problems.


\(^{170}\) Tentative Regulations on the Administration of Land Use Rights for Companies Limited by Shares, art. 9.
Lease means an agreement under which owner gives up possession and use of his property for valuable consideration and for a definite term and at the end of the term owner has absolute right to retake, control and use property. However, under PRC legal regime of land use rights, lease, as a form of disposing of land use right, has special meaning. According to the 1990 Urban Land Regulations, the land lease refers to the land user leasing the land use right to the lessee, together with the building and other accessories on the land and the lessee shall pay lessor rent. The concept of land user is not expressly defined in the 1990 Urban Land Regulations. We understand that it does not include the State because the State is regarded as the land owner. Therefore, lease of land use rights is an activity by a party who has obtained the land use right from the State or previous land users to dispose of the land use right. It is not a form of obtaining the land use rights directly from the State, it is a secondary disposition of land use rights.

The lessor can only be a land user who has obtained land use rights from the State rather than the State itself. If we regard the allocation and granting of the land use rights from the State as the first level land market, lease, transfer and mortgage can be described as the second level land market.

The lease of land from the State is not consistent with the above land use system. Based on the above definition, it is provided that the land use right shall not be leased unless the lessor has invested in, developed and used land according to the provisions in the land use right granting

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172 1990 Urban Land Regulations, art. 28.
173 Nan Luming & Xiao Zhiyue, supra note 163 at 155-57.
contract. It is impossible for such provision to apply to the lease of land from the State. Furthermore, under PRC Law, the land use right and the ownership of the buildings on the land shall not be separated. However, the land use rights obtained from the State through lease shall not be transferred, subleased or mortgaged. This means that the companies limited by shares who obtained the land use rights from the State through lease shall not transfer, sublease, mortgage or otherwise dispose of the buildings thereupon because the land use rights cannot be freely disposed. In other words, such companies cannot have complete ownership of the buildings on the leased land. In usual cases, the land users will develop the land with their own funds. If in such cases the land users cannot enjoy complete ownership of the buildings, who will enjoy the remaining part of the ownership? Nobody has valid legal basis to enjoy because all the development and construction are done by the current land users.

There is no need to create the additional form of lease. In fact, both land granting and land allocation are disguised forms of lease -- the basic concept underlying these legal relationships is that the State retains the land ownership while the land users obtain the land use rights.

On the other hand, FICLBS do not solve the problems remaining with site use rights. Site use rights are not allowed to be transferred by the site users under the Implementation Regulations of EJV Law which were promulgated in 1983. At that time, China was exercising a gratuitous

175 1990 Urban Land Regulations, art. 28. Such provision is merely to prohibit trading of land use rights without any investment on the land (chaodipi). See Wang Jiafu et al., *ibid.* at 109.


177 Tentative Regulations on the Administration of Land Use Rights for Companies Limited by Shares, art. 9.

178 Implementation Regulations of EJV Law, art. 53.
land use system. Land users do not have to pay consideration for the land use rights. Therefore, land use rights shall not be traded, leased or transferred at that time. However, the gratuitous land use system was proved to be problematic in entailing gross waste and misuse of land resources. On April 12, 1988, the First Session of Seventh NPC passed an amendment to the PRC Constitution which permits the transfer of land use rights according to the provisions of law and repeals the prohibition of lease of land use rights. On December 29, 1988, the Fifth Session of the Seventh NPC amended the Land Administration Law of PRC by adding such important provisions as “the use rights of State-owned and collectively owned land may be transferred according to law” and “the State adopts a system of using State-owned land with valuable consideration.” In 1990, the State Council promulgated 1990 Urban Land Regulations and Provisional Administrative Measures Governing Commercial Land Development and Management by Foreign Investors (Waishang touzi kaifa jingying chengpian tudi zanxing guanli banfa) which developed the constitutional principle of using State-owned land with valuable consideration into a

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179 Sun Xianzhong, Guoyou tudi shiyongquan caichanfa lun (Property Law of State-owned Land Use Rights) (Beijing: Zhongguo shehui kexue chubanshe, 1993) at 8.

180 PRC Constitution, art. 10.

181 Sun Xianzhong, supra note 179 at 9.

182 Amendment to PRC Constitution (Zhonghua renmin gongheguo xianfa xiuzheng’an) in Compilation of Laws and Regulations (January-December 1988) supra note 63 at 1, art. 2.

183 Decision of the Standing Committee of the NPC Concerning Revising “Law of PRC on Land Administration” (Quanguo renmin daibiao dahui changwu weiyuanhui guanyu xiangai “Zhonghua renmin gongheguo tudi guanli fa” de jueding) adopted at the Fifth Session of the Standing Committee of the Seventh NPC on December 29, 1988, in Compilation of Laws and Regulations (January-December 1988), supra note 63 at 621, art. 2.

detailed legal regime. However, the Implementation Regulations of EJV Law are not revised correspondingly. Because the Amendment to PRC Constitution provides that the land use rights may be transferred according to the provisions of law, the prohibition of transfer of site use rights may not necessarily be regarded as against the PRC Constitution. Nevertheless, land use rights which cannot be transferred are against the legal nature of the land use rights under the current legal regime. It is unfair for investors because they pay the same consideration as under the new land use system under which land use rights can be transferred freely. Furthermore, it is impossible to prohibit the land users from transferring land use rights in disguised forms.\(^\text{185}\)

3. **Foreign Investment Approval**

Provisional Regulations on FICLBS provide for a set of approval procedures consistent with General Foreign Investment Regime. This is in fact a double approval system by both the provincial and central governments. It can be illustrated by the following chart:

\(^{185}\) Sun Xianzhong, *supra* note 179 at 66.
* The vertical relationship in this chart is double approval regime, i.e. applications for establishment, feasibility study report and asset appraisal report shall be approved by both the second and third levels, while contracts and articles of association shall be approved by both the second and first levels.

For other foreign investment enterprises, relevant laws set thresholds of total amount of investment. Projects above $10 million in interior areas or above $30 million in coastal areas

186 These do not include special foreign investment enterprises such as foreign investment holding companies (touzixing gongs). According to Article 3 of the Tentative Regulations Concerning Foreign Investment Holding
shall be subject to the approval of the central government. Those below the threshold shall be approved by the provincial governments. The approval authorities at the provincial level can be delegated to the local governments at the level of county, city and districts. This approval system was established gradually during the first decade after China adopted open-door policy in 1978. Due to various reasons, this system is very complicated and problematic. In summary, it can be illustrated by the following chart:

Companies, the approval authority and procedures for foreign investment holding companies are similar to FICLBS.

187 See EJV Law, art. 3; CJV Law, art. 5; WFOE Law, art. 6; Implementation Regulations for EJV Law, art. 8; Implementation Regulations for CJV Law, art. 6; Implementation Regulations for WFOE Law, art. 8; Several Complementary Provisions of the State Council Concerning the Development of Foreign-oriented Economy in Coastal Areas (Guowuyuan guanyu yanhai diqü fazhàn waixiangxing jingji de ruogan buchong guiding) issued by the State Council on March 23, 1988, in Yanhai yanjiang yanbian kaifang falü fagui ji guifanxing wenjian huibian (Compilation of Laws, Regulations and Regulating Documents Concerning Opening Areas Along the Seas, Rivers and Boarders) (Beijing: Falü chubanshe, 1992) at 319; Notice of the State Council concerning Increase of the Approval Authority of Interior Provinces, Autonomous Regions, Municipalities with Separate Plan and Relevant Departments of the State Council in Attracting Foreign Investment (Guowuyuan guanyu kuoda neidi sheng, zizhi qu, jinha danli shi he guowuyuan youguan bumēn xishou waishang touzi shenpi quanxian de tongzhi) issued by the State Council on July 3, 1988, in Encyclopaedia of Laws and Regulations, vol. 8, supra note 128 at 39; and Notice of the State Council concerning Empowering the People's Government of Provinces, Autonomous Regions, Municipalities with Separate Plan to Approve Wholly Foreign Owned Enterprises (Guowuyuan guanyu shouquan sheng, zizhi qu, zhixia shi, jinha tequ he jinhua danli shi renmin zhengfu shenpi waizi qiye de tongzhi) issued by the State Council on June 9, 1988, in Encyclopaedia of Laws and Regulations, vol. 8, supra note 128 at 37.
The characteristics of simplicity and clear-cut of the approval system for FICLBS is a product of strict State control. It successfully avoids the confusions and problems created by the General Foreign Investment Regime. The approval stage is the starting stage for a foreign investment enterprise, so it deserves detailed analysis.

(a) Delegation of approval authority

As for FICLBS, there is no provision for delegating approval authority. This spares many problems deriving from delegation as provided in the General Foreign Investment Regime.

Under the Chinese law, it is simply provided that provinces, autonomous regions, municipalities directly under the central government and municipalities with separate plans are entitled to delegate their approval authorities to the counties, cities and districts within their
respective jurisdictions. Unfortunately, it is not clear who is the authority entitled to delegate. Theoretically, it should be the authority which has the approval power. Other authorities have no approval power to delegate. However, in practice, the delegation is made in some places and at some time by local governments, government departments in charge of foreign investment or local People's Congress. Nobody knows which form is correct. Neither MOFTEC nor the State Council has issued any regulation addressing this problem as yet. In this circumstance all the delegations have to be treated as legitimate because no legal basis is available to challenge any of them. Conflicts among the three forms are potential.

Another problem is whether the delegation can be made after an ultra vires approval is made by an approval authority at a lower level. It is arguable that such after-approval delegation is within the power of the delegating authority. However, if permissible, after-approval delegation may create much confusion in practice. An ultra vires approval shall be invalid and have no legal effect from the beginning. The after-approval delegation may put the legal status of a foreign investment project in a state of dangerous uncertainty because it can turn from invalid to valid at any time.

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188 See Several Complementary Provisions of the State Council Concerning the Development of Foreign-oriented Economy in Coastal Areas, art 1; and Notice concerning the Approval of Contracts and Articles of Association of Foreign Investment Enterprises by Interior Provinces, Autonomous Regions, Municipalities with Separate Plans and Relevant Departments of the State Council (Guanyu neidi sheng, zizhiqu, jihua danlie shi he guowuyuan youguan bumen waishang touzi qiye hetong, zhangcheng de tongzhi) issued by the MOFTEC on August 20, 1988 ((88) Wai Jing Mao Zi Zong Zi, No. 220) (copy on file with the author).

189 Urgent Notice Concerning the Current Approval of Foreign Investment Enterprises (Guanyu dangqian shenpi waishang touzi qiye youguan wenti de jinji tongzhi) issued by the General Office of the State Council on November 22, 1995, art. 4 (copy on file with the author).
A closely related problem is the ambiguity of the legitimacy of "one delegation for one project". Can the relevant provisions of PRC law be construed as limited to a whole-sale delegation? It is not clear whether an upper approval authority can delegate approval power to the authorities at county, city and district level for only one specific foreign investment project. No legal provision is found expressly addressing this question.

(b) Circumvention of central government approval

Multilevel approval regime makes it possible to circumvent the central government approval. This can be achieved through two ways: the first is ultra vires approval, the second is to divide a project into various ones to lower their respective total amounts of investment under the approval threshold. Although Chinese government changes its soft attitude and becomes tough on this issue by issuing two notices expressly prohibiting these two kinds of approvals and declared them invalid in 1994 and 1995 respectively,¹⁰⁰ this remains a big issue for foreign investors due to

¹⁰⁰ Article 4 of Urgent Notice Concerning the Current Approval of Foreign Investment Enterprises provides that all the approvals concerning foreign investment enterprises which do not comply with the conditions, approval power thresholds and procedures set by the State or which fail to be reported for record shall be invalid. The customs offices, tax authorities and administrations of industry and commerce shall not handle relevant procedures with them.

Sub (3), Sub (6) of Article 3 of Notice of the State Council Forwarding the Report on Examination of Fixed Assets Investments (Guowuyuan pizhuan guanyu guding zichan jiancha gongzuo qingkuang de tongzhi) issued by the State Council on June 11, 1994 (Guo Fa [1994] No. 36) (copy on file with the author) provides that approvals concerning EJV, CJV and WFOE projects above the approval thresholds shall be made according to the relevant provisions of the State. It is prohibited to divide a project into several ones for the purpose of avoiding the approval of the State. However, the notice is much softer on the legal consequences of such division. Sub 3, Article 3 of the same notice provides that all the projects contravening the above provisions shall be stopped temporarily and relevant approval formalities shall be made up.
various reasons including the conflicts between local and central governments. This greatly affects the confidence of foreign investors in China's foreign investment legal environment.

By a clear-cut double examination and approval regime, the approval regime for FICLBS eliminates delegation of approval authority and multi-level approval. All of the above problems are avoided successfully. It is in the interests of foreign investors not to face the above serious and sometimes insoluble problems entrenched in the general foreign investment approval regime.

4. Dissolution

Matters relating to the dissolution and bankruptcy of FICLBS are provided in the PRC Company Law. Provisional Regulations on FICLBS do not have any reference to this issue. Other foreign investment enterprises are governed by EJV Law and its implementation regulations, CJV Law and its implementation regulations, WFOE Law and its implementation regulations and the newly issued Liquidation Methods for Foreign Investment Enterprises. Chapter 19 of the Civil Procedure Law -- Bankruptcy and Repayment Procedures apply to all enterprise legal persons which include FICLBS and most foreign investment enterprises. In China, the Enterprise Bankruptcy Law applies only to State-owned enterprises. A new bankruptcy law aiming at all

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191 See Nicholos Howson, "When the Centre doesn't Hold", The China Business Review, January-February 1995, 8 at 8-12.

192 According to Article 2 of Liquidation Methods for Foreign Investment Enterprises, these Methods only apply to EJVs, CJVs and WFOEs. Presumably, they do not apply to FICLBS. See supra notes 124-26 and accompanying text.

enterprise legal persons, enterprises without legal person status and their investors is being drafted by the NPC.\textsuperscript{194} Besides the above laws and regulations, Accounting System of PRC for Foreign Investment Enterprises (\textit{Zhonghua renmin gongheguo waishang touzi qiye kuaiji zhidu})\textsuperscript{195} and other accounting and financial provisions provide for some regulations in regard of assets evaluation.

Under PRC law, FICLBS may be terminated in the case of insolvency and/or dissolution. A liquidation is mandatory in most cases. According to PRC Company Law, FICLBS may be dissolved in one of the following three circumstances: (i) expiration of the term of the company or an event leading to the dissolution of FICLBS according to articles occurs; (ii) the shareholders' meeting decides to dissolve the FICLBS; (iii) FICLBS conduct mergers or divisions which lead to the dissolution of the FICLBS.\textsuperscript{196} FICLBS shall also be dissolved in the case of being ordered to close because of violating laws and administrative regulations.\textsuperscript{197} This is the fourth case of dissolution for FICLBS.

PRC Company Law provides that where FICLBS are lawfully declared insolvent for having been unable to satisfy their debts, the People's Courts concerned shall, in compliance with relevant laws, organise the shareholders, persons from the relevant departments and relevant professionals to

\textsuperscript{194} See "Quanguo renda caijingwei bangongshi fuzeren jiu xin puochanfa wenti da benkan jizhe wen" (Responsible Officer of the General Office of the Finance and Economic Commission of the National People's Congress Answering Questions Posed by Press), \textit{Gaige yuebao} (Reform Monthly), 1996. 2, 36 at 36.


\textsuperscript{196} PRC Company Law, art. 190.

\textsuperscript{197} PRC Company Law, art. 192.
form a liquidation committee for the liquidation of the FICLBS. In this case, the Bankruptcy and Repayment Procedures of the Civil Procedure Law shall apply.

In the above two cases, except for FICLBS conducting mergers or divisions, FICLBS shall go through liquidation procedures and a liquidation committee shall be set up.

This regime complies with the long-established termination regime for foreign investment enterprises by eliminating some problems in the later system. The old termination regime requires liquidation for all circumstances of termination. Presumably, in a merger or division where the business goes on, liquidation is not necessarily needed. Hence the Provisional Regulations on FICLBS provide for the exception.

However, the legal regime of FICLBS does not address a long-argued problem -- the relationship between buyout and liquidation. In the case of buyout, just the same as merger and division, liquidation may be inappropriate and inefficient if the business is to continue. Because the shares of each shareholder can be freely transferred under the PRC law, it is quite possible that the foreign shares of FICLBS are bought by domestic investors and the foreign capital is lower than 25% of the registered capital of FICLBS or there is even no foreign capital in the FICLBS. It is also possible that the Chinese shares are purchased by foreign investors and the FICLBS have no Chinese domestic shares at all. Both the above situations disqualify the companies as FICLBS,

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198 PRC Company Law, art. 189.

199 See Implementing Regulations for EJV Law, arts. 102 and 103; Implementation Regulations for CJV Law, arts. 48 and 49; Implementation Regulations for WFOE Law, arts. 75 and 76.

200 PRC Company Law, art. 143.
because FICLBS are defined as companies whose shares shall be jointly held by Chinese and foreign shareholders and shares purchased and held by foreign shareholders shall constitute more than 25% of the registered capital.\textsuperscript{201} In either of these circumstances, may the business continue without being liquidated? This is the continuance of an old question for EJV which raised much debate.

In the case of a buyout, the foreign capital of an EJV may rise to 100% or decrease to lower than 25% of the registered capital of the EJV. In either case, the business entity would have to be dissolved and reincorporated in a different form. This suggests that a mandatory liquidation would follow the dissolution.\textsuperscript{202} Some Chinese lawyers and accountants address this question by challenging the meaning of liquidation. They argue that liquidation includes the form of a transfer of property rights (\textit{chanquan zhuanrang}) and a continuance of operations by the PRC partner to the EJV when the EJV contract expires or terminates prematurely.\textsuperscript{203} This opinion was arguable at that time because it is true that no specific definition or a clear description of liquidation was given. However, with the promulgation of Liquidation Methods for Foreign Investment Enterprises, the above opinion is becoming questionable. The Liquidation Methods for Foreign Investment Enterprises suggest that liquidation in China is used in its strict sense, just the same as in the common law countries. Under common law, liquidation refers to the process of reducing assets to

\textsuperscript{201} Provisional Regulations on FICLBS, art. 2.

\textsuperscript{202} See Helena Kolenda, "A Happy Ending: Buy-out in Chinese-Foreign Joint Ventures" (1989) 24 Texas Int'l L.J. 87 at 92-93. Presumably, it is the same in the case that only foreign investors remain with the business.

\textsuperscript{203} \textit{Ibid.} at 91.
cash, discharging liabilities and dividing surplus or loss, it occurs when a corporation distributes its net assets to its shareholders and ceases its legal existence.\textsuperscript{204} This clearly precludes the other meaning suggested above. Although the Liquidation Methods do not apply to FICLBS, they clearly have importance in reference as the first PRC regulations which formally define liquidation and provide for specific and detailed procedures thereof.

As far as we understand, FICLBS can only be terminated by bankruptcy and dissolution. The dissolution only takes place under the four conditions set forth above which do not include the change of the nature of the business of the FICLBS. Hence, unless the articles of association of FICLBS expressly provide otherwise, the change of business nature shall trigger neither dissolution nor liquidation.

During the liquidation, valuation of assets is usually a major concern. Neither the Provisional Regulations on FICLBS nor the PRC Company Law addresses how to evaluate the assets of FICLBS. Whether the value of assets shall be book value or market value and whether the good-will shall be included in liquidation assets are major concerns for both Chinese and foreign investors. Since the PRC Company Law provides that the liquidation committee shall be responsible for undertaking a stock-take of the assets and preparing Balance Sheet,\textsuperscript{205} the way to evaluate the assets seems to be determined by the liquidation committee unless expressly provided in the articles of association of the FICLBS. In practice, evaluation

\textsuperscript{204} See Black's Law Dictionary (6th ed., 1990) at 931.

\textsuperscript{205} PRC Company Law, art. 193(1).
has been negotiated by parties to EJVs before the emergence of the FICLBS.206 The Liquidation Methods for Foreign Investment Enterprises confirm this practice in their provisions and further provide detailed rules with regard to the evaluation of liquidation assets.207

(i) in the case there are provisions in the Contract or Articles of Association, the evaluation shall be handled according to these provisions;

(ii) in the absence of provisions in the Contract or Articles, the evaluation shall be determined through negotiation by Chinese and foreign investors and shall be reported to the examination and approval authority for approval;

(iii) in the case that there is no provision in the Contract or Articles and the Chinese and foreign investors fail to reach any agreement, the evaluation shall be determined by the Liquidation Committee according to the relevant provisions of the State and in reference to the opinions of assets appraisal organisations and shall be reported to the examination and approval authority for approval; and

(iv) in the case of the termination of an enterprise contract according to a decision by a court or arbitration organisation and in which the assets evaluation methods are provided, the evaluation shall be conducted according to the decision.

The above provisions are clear and reasonable. The evaluation of liquidation assets of FICLBS shall be conducted in reference to these provisions. As for individual FICLBS, the best way is to make detailed provisions in the articles of association of the FICLBS. The professional advice of lawyers and accountants shall be consulted. Such clauses in the contract or articles of association as allowing the participation of accountants or appraisers appointed by each promoter


207 Measures On Liquidation Procedures for Foreign Investment Enterprises, art. 29.
shall be recommended. This will ensure the smooth conducting of assets evaluation in a liquidation.

III. Summary

FICLBS are a product of a set of State policies on the basis of the General Foreign Investment Legal Regime. FICLBS develop the General Foreign Investment Legal Regime but new problems simultaneously occur. These developments and new problems must be understood in the context of Party and State policies.
CHAPTER IV  FICLBS AS A FORM OF COMPANY

The Provisional Regulations on FICLBS are very simple. They contain only 38 articles which mainly address the definition, approval and establishment procedures of FICLBS. The legal regime of FICLBS in terms of corporate capacity, structure, governance, share issue, dividend distribution, insolvency, dissolution and liquidation are governed by the PRC Company Law. FICLBS are different from the General Foreign Investment Regime in the context of company law. That is the reason why FICLBS shall be reviewed separately in the contexts of foreign investment and company legal regimes.

I. Common law influences on FICLBS

In the past few years, China fastens her steps to enact laws relating to socialist market economy and has made great progress. Much of the progress has been ascribed to the bold use and absorption of foreign legislative achievements and the introduction of international practices. Much attention has been given to the civil law origins of the PRC company law statutes. However, they also have very significant common law counterparts. In addition to the great influence of civil law, FICLBS regime uses principles and conventions drawn from common law

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208 See Provisional Regulations on FICLBS, art. 25.


and represents an important step toward international business practices.\textsuperscript{211} The contents of the PRC Company Law are viewed as "generally consistent with common law principles".\textsuperscript{212} The common law influence on FICLBS legal regime is extensive and is impossible to be exhausted. The followings are just some illustrations of important impacts of common law on FICLBS legal regime.

1. **Limited liability**

The total capital of FICLBS is divided into capital shares. Each shareholder shall assume liabilities toward the company to the extent of the amount of shares held by him. The company shall be liable for its debts to the extent of all its assets.\textsuperscript{213} FICLBS are enterprise legal persons.\textsuperscript{214} Although the concept of legal person is different from that of its counterparts in the common law,\textsuperscript{215} FICLBS are separate legal entities distinct from their incorporators. Both FICLBS and their investors are entitled to limited liabilities. Under the common law, the same principle was firmly established by *Salomon v. Salomon & Co., Ltd.*\textsuperscript{216} This case established beyond doubt that in law

\begin{footnotesize}


\textsuperscript{212} See Little, supra note 93 at 63.

\textsuperscript{213} Provisional Regulations on FICLBS, art. 2; also see PRC Company Law, art. 3.

\textsuperscript{214} See Provisional Regulations on FICLBS, art. 2.

\textsuperscript{215} For a discussion of the Chinese concept of legal person, see Guiguo Wang & Roman Tomasic, *China's Company Law: An Annotation* (Singapore: Butterworths Asia, 1994) at 8. Legal person is generally regarded as a European civil law concept. See infra note 320 and accompanying text.

\textsuperscript{216} [1897] A. C. 22.
\end{footnotesize}
a registered company is an entity distinct from its members (even if one person holds almost all of the shares in the company).\textsuperscript{217} This principle has been codified in many corporate statutes in common law countries.\textsuperscript{218} Limited liability is often said to be one of the practical reasons for creating companies.\textsuperscript{219}

2. Constitution of the company

Common law, by regarding the memorandum and articles of association as agreements between the company and the members and the members \textit{inter se}, establishes the governing position of the memorandum and articles of association in a company.\textsuperscript{220} In China, every FICLBS shall adopt articles of association from the beginning of setting up the company. They are the constitution of the company. The articles have biding force on the company, the shareholders, directors, supervisors and managers of the company.\textsuperscript{221}

3. Registration of shareholders


\textsuperscript{218} See, for example, Canada Business Companies Act, R.S.C. 1985, c. c-44, art. 45 [hereinafter CBCA].

\textsuperscript{219} Bruce Welling, \textit{Corporate Law in Canada}, 2d ed. (Toronto & Vancouver: Butterworths, 1991) at 82.


\textsuperscript{221} See PRC Company Law, art. 11.
Common law splits on whether the shareholders of a company should be registered. British Columbia Company Act (hereinafter BCCA)\(^{222}\) adopts the term “member” whose name should be entered in the company register.\(^{223}\) BCCA requires that every company shall keep a register of its members and shall promptly enter in it the names of the subscribers to the memorandum and the name of every other person who agrees to become a member of the company. Every company that fails to do so commits an offense.\(^{224}\) Every share certificate shall state on its face the name of the person to whom the certificate is issued. Hence the bearer and order forms of share certificates are excluded.\(^{225}\) While under CBCA, share certificate may be in bearer, order or registered form.\(^{226}\) A company shall maintain a securities register in which it records the securities issued by it in registered form, showing, \textit{inter alia}, the name and the latest known address of each person who is or has been a security holder.\(^{227}\)

PRC Company Law demonstrates similarity with the CBCA model. Under the PRC Company law, shares issued by a company to promoters, State-authorized investment institutions or legal persons shall be in the form of registered shares which shall state the

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\(^{222}\) R.S.B.C. 1979, c. 59.
\(^{223}\) BCCA s. 1(1).
\(^{224}\) BCCA ss. 67(1) and (3).
\(^{225}\) BCCA s. 51(1)(b).
\(^{226}\) CBCA s. 48(2).
\(^{227}\) CBCA s. 50(1)(a).
\end{flushleft}
names of the promoters, State-authorized investment institutions or legal persons. Such shares may not be registered under any other name, or under the name of a representative or a third party.\textsuperscript{228} Shares issued to the general public may be either registered shares or bearer shares.\textsuperscript{229} Hence the general public may purchase bearer shares which the companies do not maintain records of ownership. However, the statute does not provide a mechanism for identifying the owner of bearer shares for voting or distributing dividends. The owners of bearer shares have to present their certificates to the company.\textsuperscript{230}

4. Corporate governance

Common law adopts the principle of separation of ownership and control in the case of public companies.\textsuperscript{231} Despite the fact that FICLBS may be either public or private companies,\textsuperscript{232} in FICLBS’ power sharing structure, ownership and management are also separated to a limited extent although the functions of the general meetings are different from common law. Management functions are exercised by the board of directors subject to the supremacy of the shareholders in the general meeting.\textsuperscript{233}

\textsuperscript{228} The purpose of this provision is to prevent the transfer of State-owned assets to private sector.

\textsuperscript{229} PRC Company Law, art. 133.

\textsuperscript{230} See Art & Gu, \textit{supra} note 211 at 302.

\textsuperscript{231} Gower, Prentice & Pettet, \textit{supra} note 220 at 71.

\textsuperscript{232} See \textit{infra} notes 297-304 and accompanying text.

\textsuperscript{233} PRC Company Law, art. 112. Also see Wang Baoshu, \textit{“Gufen youxian gongsi jiguan touziao zhong de dongshi he dongshihui”} (Directors and Board of Directors in the Corporate Structure of Companies Limited by
Directors' and managers' fiduciary duties to the company under the common law are also incorporated into the FICLBS. Fiduciary duties are legal norms that are imposed on directors and managers in relation to their conduct with the company and shareholders. These duties ensure that the myriad corporate actors carry out their respective duties with the utmost good faith, do not put themselves in a position where their duties may conflict with self-interests, and do not derive a secret profit from their offices. At present many common law statutes codify the fiduciary duties of directors and managers as "[to] act honestly and in good faith with a view to the best interests of the company" in exercising their powers and discharging their duties. Directors and managers are also required to comply with law, articles of association and unanimous shareholders' agreement. This is called the complying duties of the directors. In China directors and managers of FICLBS are also required to abide by the articles of association of the company, faithfully perform their duties and protect the interests of the company. They are not allowed to use their positions in the company to seek personal gains.


235 Ziegel et al., *ibid.* at 491.

236 See CBCA, art. 122(1)(a).

237 See CBCA, art. 122(2).
5. The presumption of equality of shares

The presumption of equality of shares was well developed under common law. It refers to the presumption in corporate law that all shares of a company are to be treated equally in the absence of statutory provisions to the contrary or otherwise provisions in the corporate constitution. Each share is presumed to be equal to every other share in terms of the rights it embodies. These rights include: (i) dividends, (ii) return of capital on a winding up (or authorized reduction of capital), and (iii) attendance at corporate meetings and voting. As a result of this presumption, risk, control and participation in profits are equally distributed on a per-share basis unless the capital structure is subdivided into types (conventionally called "classes") of shares.

The presumption of equality of voting rights is codified in various company acts in Canada. Both CBCA and BCCA have statutory provisions that each share carries one vote unless the articles otherwise provide. The Supreme Court of Canada and British Columbia

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238 There are debates over whether all shareholders of a class must be treated equally or simply the rights that are constitutive of shares of a given class must be the same for all shares of that class. See F.H. Buckley, Mark Gillen & Robert Yalden, Companies -- Principles and Policies, 3d ed. (Toronto: Emond Montgomery, 1995) at 194. The narrower proposition is more widely accepted and Gower's view that "all shares confer the same rights and impose the same liabilities" is often quoted to support this proposition. For example, in Jacobson v. United Canso Oil & gas Ltd., [1980] 6 W.W.R. 38 (Alta. Q.B.), Justice Forsyth quoted Gower. The Supreme Court of Canada, in The Queen v. McClurg, [1990] 3 S.C.R. 1020, held that the presumption of equality was among the shares rather than among the shareholders.

239 See Gower, Prentice & Pettet, supra note 220 at 361.

240 Welling, supra note 219 at 605.

241 See CBCA s. 140(1) and BCCA s. 185(c). Their wordings are slightly different. CBCA s. 140(1) provides that, "[u]nless the articles otherwise provide, each share of a company entitles the holder thereof to one vote at a
Court of Appeal confirmed the presumption of equality of shares in terms of dividends and participation in distribution on the winding up of the company.242

PRC Company Law codifies the presumption of equality of shares as well. Under PRC Company Law, equal shares shall be entitled to equal rights and equal benefits.243 PRC Company Law does not specifically refer to share class.244 Therefore it is ambiguous what constitute “equal shares”.

With regard to the right of dividends, PRC Company Law expressly provides that equal shares shall be entitled to equal benefits.245 After the company’s debts have been paid out in the case of winding up, FICLBS should distribute the remaining assets according to the shareholders’ shareholding ratio.246 With respect to voting rights, PRC Company Law rigidly

meeting of shareholders.” BCCA s. 185(c) provides that, “[u]nless the articles of a company otherwise provide, every member shall have one vote in respect of each share held by him.” It should be noted that under BCCA, “member” is defined as a subscriber of the memorandum of the company, and includes every other person who agrees to become a member of a company and whose name is entered in its register of members or a branch register of members, see BCCA s. 1(1). Hence under BCCA, beneficial shareholders are excluded while CBCA does not have such restriction.


243 PRC Company Law, art. 130.

244 Some sources translate the words “tong gu” in art. 130 of PRC Company Law as shares of the same class, see Art & Gu, supra note 211 at 301 and CCH Translation, supra note 3. The original Chinese words “tong gu” do not specifically refer to the same class. “[T]ong” only generally means the same and “gu” means share(s). A correct translation can be found in Wang & Tomasic, supra note 215 at 113 in which art. 130 is translated as “equal shares for equal rights and equal shares for equal benefits.”

245 PRC Company Law, art. 130.

246 PRC Company Law, art. 195.
provides that each share shall give the right to one vote at a shareholders' meeting.\(^{247}\) Without the permissive provision that the articles of a company may otherwise provide as Canadian law,\(^{248}\) FICLBS cannot differentiate voting rights among shares. Such rigid adherence to the principle of equality of shares is contrary to the well-established business practice to differentiate shares into classes and many problems arise. We will discuss this later.

6. The consideration for shares

Under common law, shares may be issued for money, or, subject to observance of statutory formalities, for money’s worth, i.e., assets, services or some other valuable consideration.\(^{249}\) For example, both BCCA and CBCA provide that the consideration for shares may be paid in money or in property or past services.\(^{250}\) This provides necessary flexibility for the company to raise capital through the issue of shares. PRC Company Law permits the promoters of the company to purchase shares with cash, tangible assets, industrial property rights, non-patented technology or land use rights.\(^{251}\) Such provision can be

\(^{247}\) PRC Company Law, art. 106.

\(^{248}\) Supra note 241 and accompanying text.

\(^{249}\) H. Sutherland, ed., Fraser's Handbook on Canadian Company Law, 8th ed. (Ontario: Carswell, 1994) at 111 [hereinafter Sutherland, Fraser's Handbook].

\(^{250}\) See BCCA s. 43(2) and CBCA s. 25(3).

\(^{251}\) PRC Company Law, art. 80. It is interesting to note that PRC Company Law is totally silent on whether other investors can purchase the shares of a company in the form of property or service.
exhaustive and implies that services are not allowed to trade for shares. Notwithstanding such difference, the permission of tangible and intangible property as consideration of shares gives great flexibility to FICLBS investors under PRC Company Law.

7. Pre-emptive rights

Pre-emptive right on share issues refers to a right of shareholders whereby the company must offer existing shareholders the opportunity to subscribe for a new share offering in the proportion that their shareholdings bear to the total number of shares issued and outstanding.

Pre-emptive rights may serve two functions. First, it can make it difficult for managers of the company to issue shares for the purpose of defeating a current or anticipated takeover bid, or altering the distribution of corporate control. Secondly, pre-emptive right provisions are designed to prevent the diluting of the interests of the existing shareholders in the company.

The statutory treatment of pre-emptive rights differs considerably within Canada. BCCA recognizes that these concerns are especially strong in non-reporting companies because they are more likely to be closely held, have less well advised directors and members, and are

252 Buckley interpreted CBCA s. 25(3) in the same way. S. 25(3) of CBCA is similarly worded as art. 80 of PRC Company Law, i.e., "... may purchase shares with ... for consideration of shares." Buckley regarded such wording as prohibition of other forms as consideration of shares. See Buckley, Gillen & Yalden, supra note 238 at 218.

253 Ziegel et al., supra note 234 at 838.

254 Ibid. at 838-39.

255 Under BCCA, reporting company refers to a company (a) whose securities are listed for trading on any stock exchange, (b) that is ordered by the registrar to be a reporting company, or (c) other special circumstances unless the registrar orders that it is not a reporting company. See BCCA s. 1(1).
subject to lower disclosure standards. The provisions in BCCA acknowledge that relying on a director’s duty of good faith may not satisfactorily protect a member’s interest in a non-reporting company. BCCA mandates pre-emptive right in the case of non-reporting companies. In the event that there is only one class of shares, the proposed shares shall be offered pro rata to the shareholders. In the event that there are classes of shares, the proposed shares shall first be offered pro rata to the shareholders holding shares of the class proposed to be allotted, and if any shares remain, the remaining shares shall then be offered pro rata to the other shareholders of the company. Such cases as share exchange, conversion, amalgamation, compromise or arrangement, share dividend, employee share ownership plan and employee venture capital plan shall be excepted. The shareholders may not generally waive the pre-emptive right, but may waive in writing rights to a specific allotment. A reporting company may offer the shares directly to non-shareholders unless its memorandum or articles indicate otherwise.

Under CBCA, the pre-emptive rights of shareholders are optional. The default circumstance is that the shareholders do not have such right. Only if the articles so provide,

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257 BCCA s. 41(1).

258 BCCA s. 41(2).

259 BCCA s. 41(5).

260 BCCA s. 41(6).
shall the proposed class of shares be offered to the shareholders holding shares of that class. In this case, the offeree shareholders have a pre-emptive right to acquire the offered shares in proportion to their holdings of the shares of that class, at such price and on such term as those shares are to be offered to others.\textsuperscript{261} CBCA further provides some exceptions. In the case that the shares are to be issued, (i) for a consideration other than money, (ii) as a share dividend, or (iii) based on the previously granted conversion privileges, options or rights, the shareholders have no pre-emptive rights in respect of the shares to be issued.\textsuperscript{262} The optional nature of CBCA provisions gives companies much flexibility.

PRC Company Law seems to be based on the same reasoning. Existing shareholders have priority in contributing to a limited liability company's newly added capital.\textsuperscript{263} The theory behind this position appears to be that as limited liability companies are private companies in nature,\textsuperscript{264} they are expected to co-operate closely. Therefore, when the registered capital is to be increased, the existing shareholders should have priority in subscription in view of their prior support for the company. This may also serve to keep the corporate culture unchanged.\textsuperscript{265} PRC Company Law is silent on companies limited by

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{261} CBCA s. 28(1).
\item \textsuperscript{262} CBCA s. 28(2).
\item \textsuperscript{263} PRC Company Law, art. 33.
\item \textsuperscript{264} The number of shareholders in a limited liability company shall not exceed fifty (50). See PRC Company Law, art. 20.
\item \textsuperscript{265} Wang & Tomasic, supra note 215 at 42.
\end{itemize}
\end{footnotesize}
Due to the lack of express prohibition, it should be interpreted as permitting the articles of FICLBS to grant pre-emptive rights to existing shareholders in the case of issuing new shares. Therefore, as under CBCA, the default situation under PRC Company Law shall be that shareholders in FICLBS do not have pre-emptive right unless the articles otherwise provide.

II. Chinese Characteristics of FICLBS

This thesis intends to analyse the Chinese characteristics of FICLBS by comparing FICLBS law regime and its counterpart under the common law in three aspects: corporate capacity, corporate management, shares and dividends. In these major aspects of FICLBS law regime, distinctive Chinese characteristics can be identified.

1. Corporate capacity

Common law provides that a company has the power and capacity of a natural person of full capacity with limited exceptions. Hence the doctrine of ultra vires is abolished to a great extent. A company shall not carry on any business or exercise any power that it is restricted by its articles from carrying on or exercising, nor shall the company exercise any of its powers in a

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266 A company limited by shares may either be a public company or a private company. PRC Company Law only provides that its promoters shall not be less than five (5) persons. It can be established either through promotion or public issue. See PRC Company Law, arts. 74, 75.

267 See BCCA s. 21(1). The exceptions are: no company has the capacity to operate a railway as a common carrier or to operate as a club unless otherwise authorized. See BCCA s. 21(2). Also see CBCA s. 15(1).
manner contrary to its articles. However, no act of a company, including any transfer of property to or by a company, is invalid by reason only that the act or transfer is contrary to the articles. Hence violation of a statutory restriction on the corporate capacity which is reflected in the corporate constitution does not make the transaction invalid. Furthermore, some common law statutes provide that it is not necessary for articles of association to be passed in order to confer any particular power on the company or its directors. In a further effort to protect third parties from the influence of the doctrine of ultra vires, it is provided that no person is affected by or is deemed to have notice or knowledge of the contents of a document concerning a company by reason only that the document has been filed with relevant authority or is available for inspection at an office of the company. Constructive notice is thus declined to be acknowledged. While the above provisions are intended to prevent the company and persons with whom it contracts from raising an ultra vires defence in a breach of contract action, nonetheless a shareholder, a creditor, the relevant authority and other interested parties may sue to restrain the company, its directors and officers from engaging in activities beyond the scope of its articles. The existence of this injunctive remedy contributes to the uncertainty surrounding the entering of commercial transactions. A third party who is unaware of the ultra vires nature of the transaction may suffer a loss if the

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268 See CBCA s. 16(2), also see BCCA ss. 22(1) and (2).

269 See CBCA s. 16(3), also see BCCA s. 22(3).

270 See CBCA s. 16(1).

271 CBCA, s. 17.

272 See CBCA s. 247, also see BCCA s. 25.
shareholders of the company can block the performance of an ultra vires contract. The injunctive remedy also illustrates the agency nature of the ultra vires doctrine. With the doctrine of limited capacity and constructive notice being eliminated, the purpose clause in the corporate constitution acts as a limitation placed by shareholders on the authority of corporate representatives.

Under CBCA the purpose to completely abolish ultra vires doctrine as a defence to contractual claims has not been entirely achieved. Under CBCA a company or a guarantor of an obligation of the company may not assert against a person dealing with the company or with any person who has acquired rights from the company that the articles, by-laws and any unanimous shareholder agreement have not been complied with, except where the person has or ought to have by virtue of his position with or relation to the company knowledge to the contrary. This ambiguous provision creates a trap which cautious investors want to avoid.

Hence current legal practice in major business transactions is to ignore the statutory provision that a company has the capacity, rights, powers and privileges of a natural person, and to require a clear demonstration that the company with which one deals is in fact authorised to carry out the transaction. In practice, this results in the same demand for certified copies of corporate documents and opinion letters as occurred prior to the abolishment of ultra vires doctrine.


275 See CBCA s. 18.
However, contrary to the practices before the abolishment, third parties monitoring for compliance with the articles in major business transactions may be very efficient, since the monitoring cost will amount to a very small fraction of the consideration. In addition, monitoring costs may be trivial, since the objects need no longer be stated in the articles. Instead, if restrictions are desired, the company is to provide them, with the presumption of full capacity of a natural person replacing the former presumption of incapacity absent express authorisation. It is then an easy matter to verify that the *ultra vires* trap does not arise when the restriction clause has simply been left blank.  

*Ultra vires* doctrine survives under the PRC law not as a mechanism to protect shareholders’ interests as is the case in the common law countries, but as part of the State’s efforts to control the activities of enterprises so that they comply with State policies and plans. Under the PRC law, the business scopes of FICLBS shall be provided by their articles of association and registered according to law. FICLBS must conduct their business activities within the registered business scopes. The company registration authorities are Administration of Industry and Commerce (hereinafter referred to as AIC) at different levels. The registration authority for FICLBS is the State Administration of Industry and Commerce (hereinafter referred to

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276 See Buckley, Gillen & Yalden, *supra* note 238 at 178.


278 PRC Company Law, art. 11.

Items of the business scopes of FICLBS which are restricted by laws and administrative laws shall be subject to approval according to law. FICLBS may alter their business scopes by amending their articles of association according to legal procedures and going through alteration registration procedures with registration authority.

In contrast to common law, ultra vires activities are regarded in China as against the mandatory legal provisions. Therefore, ultra vires activities are invalid and have no legal effect from the very beginning. The company shall return the property obtained as a result of the ultra vires act to the party which has suffered loss. The company, at fault because of ultra vires, shall compensate the other party for any resulting loss. Where both parties are at fault, each shall undertake respective liabilities. In the case that the company and other parties collaborate with ill intent to harm State or collective interests or the interests of a third party, both parties shall be

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280 Article 9 of the Provisional Regulations on FICLBS provides that all the FICLBS shall be approved by MOFTEC. Article 6 of the Administrative Rules Governing the Registration of Companies provides that SAIC is responsible for the registration of companies limited by shares approved by the departments authorized by the State. MOFTEC is a ministry under the State Council - the central government of China, it can be regarded as one of "the departments authorized by the State". Therefore FICLBS should be subject to the administration of SAIC in respect of its registration.

281 See PRC Company Law, art. 11.

282 PRC Company Law, art. 11. The specific alteration and registration procedures are as follows: (1) The company passes a resolution to alter its business scope; (2) Apply for registration within thirty (30) days after such resolution is passed. In the case that the revised business scope involves items requiring approval by State authorities, application with registration authorities shall be made within thirty (30) days after the alteration is approved by relevant State authorities. No time limit is provided for a company to apply with state authorities for the required approval. See Administrative Rules of the People's Republic of China Governing the Registration of Companies, art. 29.

required to hand over the properties they have acquired, ownership of which shall revert to the State or collective, or to the third party.\textsuperscript{284} In the case that a company operates \textit{ultra vires} its business scope, the company registration authority may order correction, and may levy a fine between RMB10,000 to RMB100,000 concurrently. If the case is serious, the business license of the company may be revoked.\textsuperscript{285} Besides that, the legal representative of the company may be subject to administrative punishment and/or fine. In the case of a crime, criminal responsibilities shall be affixed according to relevant law.\textsuperscript{286}

China's \textit{ultra vires} doctrine is rooted in the planned economy.\textsuperscript{287} In the planned economy, every enterprise performs a specific role in the national economic plan. The fulfilment of the national economic plan depends on the work of various enterprises performing different designated roles. Any change of such roles without adjusting the overall plan will possibly result in the difficult working or failure of the overall economic plan.\textsuperscript{288} In a market economy, a company has to quickly respond to the frequently changed market situation in order to keep competitive. Such responses inevitably involve the variation of business scope of a company.\textsuperscript{289} Under the current

\textsuperscript{284} See Articles 58 and 61 of the General Principles of Civil Law.

\textsuperscript{285} Administrative Rules of the People’s Republic of China Governing the Registration of Companies, art. 71.

\textsuperscript{286} See General Principles of Civil Law, art. 49(1).


\textsuperscript{288} Wang Liming, Guo Mingrui & Fang Liufang, \textit{supra} note 145 at 240-41. Also see Tong Rou, \textit{China’s Civil Law}, \textit{supra} note 146 at 160.

\textsuperscript{289} Ge Xingjun, \textit{supra} note 283 at 73-74.
regime, a company has to first pass a resolution, then apply for approval and registration in order to revise its business scope. This seriously obstruct the ability of FICLBS to make quick response to market changes. With the development of China's market economy, such obstacles will become more and more large to FICLBS. Besides that, according to PRC law, the ultra vires activities shall be invalid from the very beginning. This puts the established civil relationships in a position of uncertainty. Ultra vires may also be viciously used as a defence for failure or unwillingness to honour a contractual or civil obligation.

Ultra vires is contrary to the State policy to get conformity with international practice. Because FICLBS are invested by both Chinese and foreign investors, the investors are in different jurisdictions and may possibly be subject to different company laws. Under the common law, a company may lend money to its invested companies. This is generally called shareholder's loan or advances. However, under the PRC law, no company is permitted to lend money to other enterprises except financial institutions. Therefore, no company other than financial institutions has the power of lending in its business scope. Any lending by other companies is regarded as ultra vires and thus invalid. This puts FICLBS in an awkward position: it is able to obtain shareholder's

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290 Some common law jurisdictions have statutory provisions permitting companies to lend money. Where the governing statute does not contain an express provision, the power to loan is a common power to be inserted in the memorandum. Companies other than banks may validly lend at any stipulated rate of interest. See Harry Sutherland et al., Fraser & Stewart Company Law of Canada, 6th ed. (Ontario: Carswell, 1993) at 80-81 [hereinafter Sutherland et al., Fraser & Stewart Company Law].

291 See Decision on Reforming Financial System (Guanyu jinrong tizhi gaige de jueding) issued by the State Council on December 25, 1993, in Encyclopedia of Laws and Regulations, vol. 5, supra note 128 at 257. Also see Wu Yurui et al., Xin jingji hetong fa shiyi (Explanation of the New Economic Contract Law) (Beijing: Zhongguo renmin gongan daxue chubanshe, 1993) at 55.
loan from foreign investors while cannot from Chinese investors. In fact this is so irrational that in recent years many Chinese enterprises (including domestic) lend money to each other in order to meet their capital needs. This phenomenon reflects the fact that *ultra vires* is not able to meet the needs of modern enterprises in a market economy.

2. Corporate Governance

As discussed above, FICLBS adopt the principle of separation of ownership and management which has long been established under the common law. However, distinctive Chinese characteristics still exist in respect of corporate governance.

2.1 The supremacy of shareholder's meeting

Under common law, the principle of the separation of ownership and management renders management, in the exercise of its powers, independent of the general meeting in the case of publicly held companies. The directors are not agents of the general meeting; they enjoy an authority constitutionally independent of it, limited only by the company law, the articles of association and resolutions altering the articles.\(^{292}\) Under company statutes, management is identified with the directors. The directors shall manage the business and affairs of the company.\(^{293}\) This presumption has significant effect in practice. In articles of association, the board may be

\(^{292}\) See Leigh, Joffe & Goldberg, *supra* note 217 at 131.

\(^{293}\) See CBCA s. 102, BCCA s. 141(1).
empower to "exercise all such powers and do all such acts and things as the company may exercise and do". Restrictions will be listed in the articles. While the general meeting, among the powers reserved to it, is entitled to change the memorandum, articles of association and the appointment and dismissal of directors. The separation principle is so firmly established that in *John Shaw & Sons (Salford), Ltd. v. Shaw*, Greer L.J. stated that,

"[a] company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors, certain other powers may be reserved for the shareholders in general meeting. If powers of management are vested in the directors, they and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles in the directors is by altering the articles, or if the opportunity arises under the articles, by refusing to re-elect the directors of whose action they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders."

Considering the absolute management right of board of directors both provided for in company statutes and in generally accepted articles as described above, the shareholder's meeting is accordingly limited to alteration of articles and changing directors rather than directly participating in the management of the company.

FICLBS may be either public companies or private companies. PRC Company Law does not distinguish public held and privately held companies in the case of companies limited by shares. Companies limited by shares may be established by way of promotion or public issue.

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294 See BCCA Table A - Articles of Association, art. 10.1.

295 [1935] 2 K. B. 113 (C.A.) at 134.

296 PRC Company law, art. 74.
case of promotion, all the shares are subscribed by promoters and will not be issued to the general public.\textsuperscript{297} The method of promotion will generally create private companies although neither PRC Company Law nor the Provisional Regulations on FICLBS have any restrictions on the maximum number of the promoters.\textsuperscript{298} There is no doubt that public issues will make a company limited by shares a public company.

One of the basic distinctions between a limited liability company and a company limited by shares is that a company limited by shares has access to the general public. When a company limited by shares is established, it has the choice to select public issue.\textsuperscript{299} After the establishment, it has the choice to select public issue in the case of increasing its registered capital.\textsuperscript{300} The shares of a company limited by shares can be sold through stock exchanges.\textsuperscript{301} Although theoretically, a company limited by shares has the discretion to select whether to list its shares on a stock exchange, companies limited by shares are generally expected to be listed and this constitutes one of the fundamental differences between a company limited by shares and a limited liability company.\textsuperscript{302} Unless converted into a company limited by shares, a limited liability company cannot issue shares to the general public. Although it is problematic failing to distinguish

\textsuperscript{297} PRC Company law, art. 74.

\textsuperscript{298} A limited liability company shall not have more than fifty (50) promoters. See PRC Company Law, art. 20.

\textsuperscript{299} PRC Company Law, art. 74.

\textsuperscript{300} PRC Company Law, art. 139.

\textsuperscript{301} PRC Company Law, art. 151.

\textsuperscript{302} See Torbert, supra note 210 at 50.
private and public companies in the case of companies limited by shares, due to the costs involved in the establishment of a company limited by shares, it is anticipate that the method of promotion will be less commonly used than the method of public issue. Therefore, PRC Company Law tends to treat limited liability companies as private companies and companies limited by shares as public companies.

PRC law provides shareholder's meeting as the supreme and most powerful authority within FICLBS. It enjoys extensive management powers including the right to decide on the business operation strategies and the investment plans of the FICLBS. While the board of directors is only empowered to decide on more specific business operation plans and investment schemes. It is expressly provided that the board of directors shall report work to the shareholders' meeting and shall perform the resolutions of the shareholders' meeting. What is envisaged according to the Chinese text of the above provisions is that shareholders will exercise their ultimate authority by establishing the company's broad investment and operational plans and principles. The board will implement these plans by setting and implementing specific operational and investment strategies. For example, the shareholders may decide to invest in the steel industry, indicating an upper limit

303 Wang & Tomasic, supra note 215 at 74.
304 PRC Company Law, art. 102.
305 PRC Company Law, art. 103(1).
306 PRC Company Law, art. 112(3).
307 PRC Company Law, art. 112(1).
308 PRC Company Law, art. 112(2).
of such investment, whereas the board will supervise the actual investment decision, including
negotiation of terms, selection of the location of the plant, hiring employees and so on.\textsuperscript{309} A
general meeting of the shareholders is held annually.\textsuperscript{310} In order to facilitate the shareholders to
fulfil their functions as described above, a provisional general meeting is provided to be held within
two months of the request of shareholders holding over ten percent (10\%) of the shares of the
company.\textsuperscript{311}

However, all the powers of shareholders must be exercised on the basis of the information
provided or disclosed by the board of directors. As the management of FICLBS, directors are
responsible for the convention of the general meeting and preparing the information and data to
shareholders.\textsuperscript{312} The exercise of the supreme position of general meeting will inevitably heavily
rely on the correctness and completeness of the information provided to shareholders by directors.

Fortunately, PRC law provides two means to facilitate shareholders in general meeting to
exercise their supreme powers. One is the restricted business scope and the other is the supervisory
board.\textsuperscript{313} Shareholders, especially foreign investors, will generally make investment in the fields

\__\textsuperscript{309} See Little, \textit{supra} note 93 at 65.

\textsuperscript{310} PRC Company Law, art. 104.

\textsuperscript{311} PRC Company Law, art. 104(3). Other circumstances which can trigger a provisional general meeting are:
(i) the number of members of the board of directors falls below the number set forth in the PRC Company Law,
or less than two-thirds the number in the articles of the company; (ii) the deficit reaches one-third of the amount
of the capital share; (iii) the board of directors considers it necessary; and (iv) the board of supervisors proposes
a general meeting. Generally see PRC Company Law, arts. 104(1), (2), (4) and (5).

\textsuperscript{312} PRC Company Law, arts. 103, 105 and 112.

\textsuperscript{313} See Little, \textit{supra} note 93 at 65-66.
they have been engaged in for a long time and in other countries. Motorola is investing in the telecommunication, Westinghouse is investing in power industry, while Nabisco is investing in food industry in China. They have rich experience in these investment fields. They may find it easier to review the actions of the board of directors when the company's activities are tightly defined and directors are prohibited from accepting new opportunities as they arise without consultation.\textsuperscript{314} The second means is the supervisory board. The supervisory board has rights to: (i) examine financial records, (ii) oversee the propriety of the manager's activities; (iii) oversee the propriety of the board of directors' activities; and (iv) attend the board meetings as nonvoting members. Current directors, the managers and the chief financial officer are ineligible to serve on the supervisory board.\textsuperscript{315} The above functions reduce the extent to which shareholders of FICLBS rely on the information provided by directors. However, the effectiveness of the work of the supervisory board or of the supervisors will also depend upon the access to corporate information which is available to them and upon their ability to assess this information.\textsuperscript{316} Without adequate information, such as through access to accounting records and to the auditor of the company's accounts, the supervisory board is in danger of being somewhat symbolic.\textsuperscript{317}

\subsection*{2.2 Legal representative}

\footnotesize{\textsuperscript{314} For a discussion of the restricted business scope of FICLBS, see \textit{supra} notes 277-86 and accompanying text.}

\footnotesize{\textsuperscript{315} PRC Company Law, art. 124.}

\footnotesize{\textsuperscript{316} Wang & Tomasic, \textit{supra} note 215 at 60.}

\footnotesize{\textsuperscript{317} \textit{Ibid}.}
Legal representative (fading daibiao ren) is originally a civil law concept. Under German law, in the case of a limited liability company (GmbH), all business matters of a GmbH are managed by one or several managing directors who have full and unlimited powers to represent the GmbH in all matters, including day-to-day business matters, but also unusual business matters, such as the acquisition of real estate, of shares in other companies and the like. This broad power of a managing director cannot be limited vis-à-vis third parties, except that a managing director’s powers may be limited by the requirement that he be only authorised to sign jointly with another managing director of the GmbH. If a GmbH has several managing directors, they can only act for the company jointly, unless otherwise provided in the articles (which is very common).\(^{318}\)

Under common law the issue relating to corporate contracts is governed by the law of agency.\(^ {319}\) There are two major ways in which an agent can bind his principal to a third party. The first of these arises by agreement between principal and agent, whereby the former clothes the latter with actual authority to act on his behalf. The scope of the authority depends solely on the terms of the agency agreement. The second major way by which an agent can bind his principal is by means of ostensible authority. This is sometimes referred to as apparent authority or agency by estoppel. It arises not by agreement between principal and agent but through the relationship between principal and third party. The principal holds out the agent as possessing the actual


\(^{319}\) Welling, supra note 219 at 173-75.
authority to bind the principal, and the third party contracts with the agent in reliance on this representation. Thereafter the principal is estopped from denying the agent’s authority.320

According to agency theory, the actual authority of an officer of a company may be determined by articles of association, his contract of employment, a board resolution, statutes, even from a board notice.321 Apart from this, merely appointing a person to serve as an officer will clothe him with the actual authority to make the business decisions that a person in his position usually makes, unless that authority is expressly restricted in some way by the company.322 For example, the secretary of the company will be presumed to have the authority to certify corporate documents as being the documents of the company, while the treasurer or chief financial officer will ordinarily have the authority to sign certificates with respect to the financial affairs of the company. Neither these officers nor a director will ordinarily have actual authority to make business decisions, though the president or chief executive officer will generally be deemed to be authorised to make a broad range of investment decisions in the ordinary course of the company's business.323

On the other hand, if a company is held out or represented that the agent has the authority to act on behalf of the company, the company is estopped from denying the authority. This was

320 See Buckley, Gillen & Yalden, supra note 238 at 34.
321 Ibid. at 179.
322 Ibid.
323 Ibid.. For a detailed discussion of authority of particular officers, see Sutherland et al., Fraser & Stewart Company Law, supra note 290 at 129-34.
established by *Freeman & Lockyer v. Buckhurst Park Properties (Mangal) Ltd.* in which not only was the above rule established, Diplock L.J. also summarised four conditions to establish an ostensible (apparent) authority:

(i) that a representation that the agent had authority to enter on behalf of the company into a contract of the kind sought to be enforced was made to the contractor;

(ii) that such representation was made by a person or persons who had "actual" authority to manage the business of the company either generally or in respect of those matters to which the contract relates;

(iii) that he (the contractor) was induced by such representation to enter into the contract, that is, that he in fact relied on it; and

(iv) that under its memorandum or articles of association, the company was not deprived of the capacity either to enter into a contract of the kind sought to be enforced or to delegate authority to enter into a contract of that kind to the agent.\(^{324}\)

A further development of case law solves the problem of whether a deficiency in the internal procedure of a company has any impact on third parties dealing with the company. The case law following the *Royal British Bank v. Turquand*\(^ {325}\) decision sets the rule that "where a party dealing with the company ascertains the existence [of power] on the part of the company to do the act, that is to make and give him the obligation, he may go on with the dealing without inquiring as to the formalities that may have been prescribed as preliminaries. He may presume without inquiry that these have been properly attended to."\(^ {326}\) This is called the indoor management rule.\(^ {327}\)

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\(^{324}\) [1964] 2 Q.B. 480 (C.A.) at 505-506.

\(^{325}\) (1856), 6 E. & B. 327 (Ex. Ch.).

\(^{326}\) See *Sheppard v. Bonanza Nickel Mining Co. of Sudbury* (1894), [1895] 25 O.R. 305 (Ont. Ch.) at 310.

\(^{327}\) See Buckley, Gillen & Yalden, *supra* note 238 at 181.
Many common law jurisdictions have codified the case law in this regard and have statutory indoor management rules. They are functioning very well.\(^{328}\)

China did not develop the theory of agency -- neither actual nor ostensible authorities as common law countries. On the contrary, the European legal representative system was introduced.

Under PRC law, legal representative is a natural person who is the major responsible person and exercises the powers on behalf of the enterprise according to law or articles of the enterprise.\(^{329}\) PRC law adopts a system called \textit{“fading danyi zhi”} (provided by statutes and single).\(^{330}\) \textit{“Fading”} (provided by statutes) means that the legal representative of an enterprise shall be designated in compliance with the procedures specified in law and articles of association. \textit{“Danyizhi”} (single) means that there is only one legal representative in one enterprise.\(^{331}\)

The reason why China adopts the legal representative system can be found in the history of the State-owned factory management system. In 1953, China began its large scale economic construction and the first five-year plan. During that time, the Factory Director Responsible

\(^{328}\) For example, CBCA s. 18 provides, \textit{inter alia}, that a company or a guarantor of an obligation of the company may not assert against a person dealing with the company or with any person who has acquired rights from the company that (i) the articles, by-laws and any unanimous shareholder agreement have not been complied with, (ii) a person held out by a company as a director, an officer or an agent of the company has not been duly appointed or has no authority to exercise the powers and perform the duties that are customary in the business of the company or usual for such director, officer or agent, or (iii) a document issued by any director, officer or agent of a company with actual or usual authority to issue the document is not valid or not genuine. In Canada, Alberta and Ontario have similar provisions, Alberta Business Companies Act, S.A. 1981, c. 44, s. 18 [hereinafter ABCA]; Ontario Business Companies Act, R.S.O. 1990, c. B.16, s. 19 [hereinafter OBCA].

\(^{329}\) See General Principles of Civil Law, art. 38.

\(^{330}\) Wang Baoshu, \textit{supra} note 233 at 107-108

\(^{331}\) \textit{Ibid.}
System was introduced from the former Soviet Union. The factory director was responsible for the overall work of the enterprise. This was later developed into the Factory Director Responsible System under the leadership of the Party. In 1984, China launched its movement to reform the State-owned enterprises. Factory Director Responsible System was re-established. Under this system, the director of the enterprise shall take charge of the production, operation and administration work of the enterprise. In October 1984, the Central Committee of the CPC pointed out in the Decision Regarding Economic Structure Reform (Zhonggong zhongyang guanyu jingji tizhi gaige de jueding) that Factory Director Responsible System was a requirement of modern enterprises and should be kept on. Hence, the General Principles of Civil Law which were enacted in 1986 adopted the system of legal representative to ensure the Factory Director Responsible System. After the General Principles of Civil Law, Tentative Regulations Concerning the Conditions for Examination, Approval and Administration of Registration of Legal Representatives of Enterprises (Qiye faren de fading daibiao qun fangwen shenpi tiaojian he dengji guanli zanxing guiding) (hereinafter Legal Representative Regulations) and Administrative Regulations

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332 Jiang Ping et al., Faren zhidu lun (On Legal Person System) (Beijing: Zhongguo zhengfa daxue chubanshe, 1994) at 314-16.

333 Notice Regarding Sincerely Handle the Experiment Work of Reforming the Leadership System of State-owned Industrial Enterprises (Guanyu renzhen gaohao guoying gongyie qiye faren tizhi gaige shidian gongzuo de tongzhi) jointly issued by the General Office of the Central Committee of CPC and the General Office of the State Council on May 18, 1984 (copy on file with the author).


335 Jiang Ping et al., supra note 332 at 317-18.

for the Registration of Enterprise Legal Persons (Qiye faren dengji guanli tiaoli)\textsuperscript{337} were promulgated. These three Law and Regulations constitute a complete regime of legal representative (hereinafter General Legal Representative Regime).

Under the General Legal Representative Regime, the legal representative is entitled to participate in civil activities on behalf of the enterprise, but is also obliged to be fully responsible for the production, operation and management of the enterprise.\textsuperscript{338} The duly registered legal representative is the signatory who is entitled to exercise the powers of the enterprise on its behalf.\textsuperscript{339} The documents signed by the legal representative have the same legal effect as those affixed with the official seal of the enterprise. Both of these two kinds of documents have binding force on the enterprise legal person.\textsuperscript{340} No other natural person is entitled to represent the enterprise unless otherwise authorised by the legal representative or the company.\textsuperscript{341} In the case that the legal representative entrusts other person(s) to exercise his or her powers (including, of course, the power to represent the enterprise), a written power of attorney is required.\textsuperscript{342} The powers required by law to be exercised only by legal representatives shall not be delegated.\textsuperscript{343} The

\begin{itemize}
\item \textsuperscript{337} Promulgated by the State Council on June 3, 1988, in \textit{CCH: Business Regulation}, vol. 2, \textit{supra} note 1 ¶ 13-542.
\item \textsuperscript{338} Legal Representative Regulations, art. 4.
\item \textsuperscript{339} Administrative Regulations for the Registration of Enterprise Legal Persons, art. 11.
\item \textsuperscript{340} Legal Representative Regulations, art. 5.
\item \textsuperscript{341} Yu Xianyu, "\textit{Wuoguo ying jianli zenyang de faren zhidu}"(What a Legal Representative System Should China Establish), \textit{Faxue} (Jurisprudence), 1985, 9, in Zhang Xinbao et al., eds., \textit{Xin zhongguo minfaxue yanjiu zongshu} (Overview of Civil Law Literature in New China) (Beijing: Zhongguo shehui kexue chubanshe, 1990) at 120.
\item \textsuperscript{342} Legal Representative Regulations, art. 6.
\end{itemize}
signature of the legal representative shall be filed with the enterprise registration authority for record. \(^{344}\) Such provision may imply that only after registration for record with enterprise registration authority, shall the signatures of the legal representative have binding force. \(^{345}\)

PRC Company Law sets forth systematic and clear provisions regarding the powers of the legal representative in forms of both mandatory provisions and discretionary provisions. \(^{346}\) The subsequent Regulations on the Administration of Company Registration set forth the formalities concerning the registration and alteration of legal representative of companies established under the PRC Company Law and penalty provisions. These two Law and Regulations (hereinafter Company Law Legal Representative Regime) are different from the General Legal Representative Regime. Under Company Law Legal Representative Regime, the chair of the board of directors of companies limited by shares is the legal representative of the company. \(^{347}\) The legal representative has only three statutory powers: (i) preside over the general meeting, convene and preside over board meetings; (ii) examine the implementation of the board resolution; and (iii) sign the securities and bonds of the company. \(^{348}\) The board of directors may at discretion delegate some powers of

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\(^{343}\) Legal Representative Regulations, art. 6.

\(^{344}\) Legal Representative Regulations, art. 5.

\(^{345}\) Jiang Ping et al., *supra* note 332 at 361.


\(^{347}\) PRC Company Law, art. 113.

\(^{348}\) PRC Company Law, art. 114.
the board to the chair during the close time of the board meeting. Only when the chair is unable to perform his or her official duties, shall a vice chair designated by the chair exercise the chair’s functions on behalf of the chair.

General Legal Person Regime subjects legal representatives to responsibilities for the misconduct of the enterprise. When an enterprise legal person commits such illegal offences as (i) carrying out illegal business activities beyond the scope of business approved by and registered with the registration authorities; (ii) concealing the true facts from the registration or tax authorities, or practising fraud; (iii) extracting funds or concealing assets for the purpose of evading debts; (iv) disposing of property without authorisation following dissolution, annulment or declaration of bankruptcy; (v) failing to apply immediately for the registration and make public announcement of a change or of termination, causing an interested party to sustain substantial loss; or (vi) engaging in other activities prohibited by law, causing damages to State or common public interests, the legal representative of the enterprise may be subject to administrative sanctions (xingzheng chufen) or a fine. In the case that a crime is constituted, criminal liabilities shall be investigated and determined according to the law. Such harsh liabilities may be inappropriate in the Company Law Legal

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349 PRC Company Law, art. 120.
350 PRC Company law, art. 114.
352 General Principles of Civil Law, art. 49.
Representative Regime where the legal representative has considerable limited powers. It is unreasonable to apply such harsh liabilities to the chair of the board of a company limited by shares, especially for him to be responsible for the misconduct of the company.\(^{353}\) It should be noted that all the penalty clauses under Chapter Ten of the PRC Company Law and Chapter Eleven of the Regulations on the Administration of Company Registration (the Chapters on legal responsibilities) never impose any liability on legal representative of a company. References are made to responsible personnel who are directly in charge, other responsible persons, directors, supervisors, managers, shareholders, promoters, company and etc., but no reference is made to the legal representative of a company.\(^{354}\) The intentional avoidance of subjecting legal representative to harsh legal liability may reveal the recognition of the conflicts between the General Legal Representative Regime and the modern company system on the part of lawmakers of China.

The Factory Director Responsible System and the subsequent General Legal Representative Regime were implemented as forms of managing State-owned enterprises which did not have anything like board of directors responsible for the management of the enterprise. FICLBS are totally different from them. Therefore, the General Legal Representative Regime may not fit in with such companies as FICLBS. Even in Germany, in the case of a stock company, a Board of Managers holds the rights of management and representation for the stock company. The distribution of management tasks and of the sole or joint right of representation among members of

\(^{353}\) General Principles of Civil Law, art. 49. Such provision is reasonable under the General Legal Representative Regime where the legal representative is “fully responsible for the production, operation and management” of the company. See Legal Representative Regulations, art. 4.

\(^{354}\) PRC Company Law, Chapter 10.
the Board of Managers is usually dealt with in the articles of the stock company. If there are no such specific rules, the stock company is represented by all members jointly. In the case of FICLBS, general meeting is the supreme authority of the company, board of directors has extensive powers to manage the company. Although the chair of the board is the legal representative of the FICLBS, his or her management powers should be subject to articles of association, the general meeting and the board of directors. Because the legal representative shall be subject to the articles, general meeting and board of directors, it is problematic to provide that all the documents executed by the legal representative have binding force on FICLBS as under the General Legal Representative Regime.

Nevertheless, it is also problematic to assume that PRC Company Law establishes a separate system excluding all the provisions of the General Legal Representative Regime. We can find no legal basis to exclude the application of the General Legal Person Regime to companies limited by shares. In any sense all the provisions of the General Principles of Civil Law are still in full effect. No legal basis can be found to limit the application of such fundamental law as General Principles of Civil Law in China. How to deal with the relationship between these two regimes remains unclear. Therefore, even under the PRC Company Law, legal representatives may have potential powers in addition to the three statutory powers and those delegated to him or her by the board. Simultaneously, he or she may also bear potential liabilities for the misconduct of companies.

See Hering, supra note 318 at 34.
2.3 Director's duties

As discussed above, the basic common law principles of director's duties are incorporated into the legal system of FICLBS. However, it is not to say that the framework for director's duties in China is totally the same as common law countries.

In common law, the fiduciary duties of directors are so strict that the company's interests become the only thing that the directors shall consider. All the others are legally irrelevant. This is called the "Collateral Purpose Doctrine". According to this doctrine, the powers conferred upon directors may only be exercised for the benefit of the company, and must not be exercised for that of any person other than the company.\(^356\) Hence traditionally, social responsibility of a company is criticised as against the corporate purpose and the efforts seeking to assume social responsibility on the company is believed "not within the lawful powers of a board of directors".\(^357\) Although recently this traditional doctrine has been criticised, it has never been removed. Another issue is the employee's interests. With regard to a decision by directors of a to-be-assigned company to apply the entire proceeds of the company to cover the payment of various entitlements of those employees who were to be terminated and use the remaining to make voluntary severance compensation to them, it was ruled that,

\[\text{"the defendant [directors] were prompted by motives which, however laudable, and however enlightened from the point of view of industrial relations, were such as the law does not recognise as a sufficient justification. Stripped of all its side issues, the essence of the matter is this, that the directors of the defendant company are proposing}\]

\(^356\) Leigh, Joffe & Goldberg, *supra* note 217 at 172.

that a very large amount of its funds should be given to its former employees in order to benefit those employees rather than the company, and that is an application of the company's funds which the law, as I understand it, will not allow."

Notwithstanding cases such as *Dodge v. Ford Motor Co.* and *Parke v. Daily News Ltd.*, courts have consistently upheld the power of companies to make charitable contribution on the basis of "enlightened self-interest". However, neither case law nor statutes subject directors to an obligation to take into account the social liability of the company and the employee's interests. Furthermore, the allowed "charity" should be for the "enlightened self-interest" of the company. It is believed, "charity has no business to sit at board of directors *qua* charity. There is, however, a kind of charitable dealing which is for the interest of those who practise it, and to that extent and in that garb (I admit not a very philanthropic garb) charity may sit at the board, but for no other purpose."

Under the PRC Company Law, director's duties to the company are seriously diverged by the social liability and the interests of employees. PRC Company Law puts (i) the lawful rights and interests of the companies, shareholders and creditors, (ii) maintaining social economic order, and (iii) the development of socialist market economy parallel in its purpose clause. Social responsibility and public interests are evident not only in the above general principles but also in more specific provisions. For example, when engaging in business activities, a company shall

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361 PRC Company Law, art. 1.
abide by the law and observe professional ethics, enhance the building of socialist spiritual civilisation and accept supervision of the government and the general public. No detailed rules are set out to interpret these additional liabilities of FICLBS. The directors of FICLBS, who are the management of FICLBS, will surely face an awkward position when they try to balance the interests of FICLBS and the social liability.

With regard to the employees of FICLBS, not only their interests shall be considered by FICLBS, they are also entitled to participate in the management of FICLBS. FICLBS shall consult the trade union and employees prior to making decisions concerning the salaries and welfare of the employees, production safety, labour protection, labour insurance and other matters involving the interests of the employees and shall invite representatives from the trade union or from their bodies of employees to attend relevant meetings but they shall not have the right to vote. FICLBS shall take into account the opinions and suggestions of the trade union and its employees when discussing and deciding upon major and important issues in respect of the production, operation or the formulation of important rules and regulations of the companies.

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363 Such participation does not seem to be significant to companies limited by shares under the PRC Company Law. Art. 16 of the PRC Company Law provides that a State wholly owned company and a limited liability company established by two or more State-owned enterprises or by two or more State investment bodies as the main investors shall implement democratic management through the employee’s representative assembly and other means. While companies limited by shares are not required to implement democratic management.

364 PRC Company Law, art. 121.

365 PRC Company Law, art. 122.
Undoubtedly, the codification of the social liability and taking account of employee's interests seriously affect the directors to perform their duties to the company in the course of managing FICLBS at the purpose level. The participation of employees and trade unions in the decision making process obstruct the director's duties at the technical level.

The doctrine of social liability and public interests can be traced back to earlier legislation for State-owned enterprises. It is an official belief that State-owned enterprises are units of commodity production and operation in the society. All the assets of the State-owned enterprises are owned by the whole people. It is therefore natural for an enterprise to bear social liabilities and take into account public interests. The provisions relating to employees and trade unions in the FICLBS law regime find their roots in the old prevailing belief that workers are the master (zhurenweng) of the State and so of the State-owned enterprises. The State-owned enterprises exercise a combination system of collective leadership and individual responsibility. The director of a factory (changzhang) or manager of an enterprise (jingli) is responsible in the enterprise while the enterprise is subject to democratic management through workers' representative meetings and other forms. The trade union is responsible for organising workers and employees to take part in the democratic management and supervision. State-owned Enterprise Law even accords workers and employees the right to remove the director of the enterprise subject to the government

366 State-owned Enterprise Law, art. 2.
367 State-owned Enterprise Law, art. 9.
368 State-owned Enterprise Law, arts. 7 and 10.
369 State-owned Enterprise Law, art. 11.
approval, and the right to veto or decide on issues relating to welfare, remuneration and labour protection. PRC Company Law reflects the same policy orientation.

The legal regime of FICLBS represents a much step forward. In respect of management, they are not required to implement democratic management as is the case of State wholly owned companies and limited liability companies established by two or more State-owned enterprises or by two or more State investment bodies as the main investors. In respect of social liability and public interests, in addition to all those provided in the FICLBS legal regime, State-owned enterprises shall develop commodity production, create wealth, increase savings and satisfy the ever-growing material and cultural needs of society. While upholding the development of socialism's material civilisation, State-owned enterprises shall at the same time support the strengthening of socialism's spiritual civilisation and the building of teams of idealistic, moral, educated and disciplined workers. In addition to the above obligations, State-owned enterprises shall also stick to the socialist road and shall protect the State property. A State-owned enterprise shall increase the quality of its staff and workers through the promotion of ideological

370 State-owned Enterprise Law, art. 52.
371 PRC Company Law, art. 16.
372 State-owned Enterprise Law, art. 3.
373 State-owned Enterprise Law, art. 4.
374 State-owned Enterprise Law, art. 5.
375 State-owned Enterprise Law, art. 40.
and political education, education in areas such as the legal system, national defence, science and culture and technical training.\textsuperscript{376} FICLBS bear no such obligations.

Despite the above broad provisions, no measures are taken to ensure a State-owned enterprises to fulfil their social responsibilities. The democratic management of State-owned enterprises never functioned well. It is pretty rare for workers and employees to elect a director or manager of a State-owned enterprise.\textsuperscript{377} The functions of trade unions are summarised by the workers and employees of the State-owned enterprises as two: birth control and granting free film passes to workers.\textsuperscript{378}

The historical limited functions of the provisions may not be strengthened in a short time. The less strength in the wording of the FICLBS legal regime also reveals the government's attitude not to strengthen these provisions. Hence the directors in FICLBS may still serve exclusively for the best interests of FICLBS with limited restrictions.

3. Shares and dividends

3.1. Classes of shares

\textsuperscript{376} State-owned Enterprise Law, art. 42.

\textsuperscript{377} The right of the workers and employees to elect the director or manager of a State-owned enterprise is subject to the permission of the government. A wide practice of this provision will deprive the power of the government which is against the long-term policy of State control over economies in China.

\textsuperscript{378} This is a saying widely spread unofficially. Birth control is the strict State policy. However, it is generally considered insignificant in the current China where production and business operation are regarded as the most important issues in an enterprise. Film tickets are regarded as one of the few welfare trade unions can provide to workers and employees.
FICLBS law regime and PRC Company Law are entirely silent on one of the most important aspects of shares -- the division of classes. In Canada, although the statutes have no definition of what constitute a class of shares, the term "class" is not only frequently referred to in the statutes but also forms the basis of some important legal concepts and principles. Members who hold shares of a particular class are entitled to convene a class meeting.\(379\) Special rights and restrictions attached to a class are protected from being prejudiced or interfered with by requiring a separate resolution of the class to approve any alteration thereof.\(380\) The concept of share classes is not technical in nature, but rather is simply the accepted means by which differential treatment of shares is recognized in the articles of incorporation of a company.\(381\) Under common law, shares are traditionally divided into "common" shares and "preferred" or "preference" shares.\(382\) Preferred or preference shares usually refer to shares which carry a long-term, special liquidation preference, have fixed dividend rights which are payable in priority to dividends to other shareholders, and often have either contingent voting rights or no voting rights at all. A given company might have more than one class of such shares, differing from one another in varying degrees. Common shares are traditionally used to describe shares that have no restrictions and that are fully participating

\(379\) BCCA s. 1(1) defines a "class meeting" as a meeting of members who hold shares of a particular class.

\(380\) BCCA s. 250. Unfortunately, BCCA is silent on what constitute class rights. There are disputes over the contents of class rights. Arguably, class rights should include at least the three fundamental rights of shares, i.e., the right to dividends, the right of voting and the right to participate in the distribution of surplus on winding up of the company.


\(382\) Welling, supra note 219 at 612.
as to voting, dividends, and dissolution. These terms are jargon words with no fixed legal meanings.\textsuperscript{383}

Both CBCA and BCCA permit the articles of the company to provide for more than one class of shares with special rights and restrictions attached. However, such provisions are permissive rather than mandatory. They do not mandate that different classes should have different rights or restrictions attached. It is commonly done in practice that two classes of common shares are identical in every respect. However, recent cases seem to indicate that there should be differences between classes regardless of the long-standing practice.\textsuperscript{384} On the other hand, under CBCA, in the case that a company only has one class of shares, all shares shall be equal.\textsuperscript{385} Hence, it is necessary to create separate classes to draw distinction between shares.

However, some memorandum jurisdictions do not have the same statutory provision as CBCA. BCCA only permits a company to set up different classes with special rights and restrictions attached and does not mandate that the only way to attach different rights or

\begin{footnotesize}
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\item\textsuperscript{383} \textit{Ibid.}
\item\textsuperscript{384} \textit{Champ v. The Queen} (1982), [1983] 21 B.L.R. 1 (Sask. F.C.C.). In this case, Mr. Champ set up a company with class A (divided into voting shares and non-voting shares) and class B (divided into voting shares and non-voting shares) shares held by himself and his wife respectively. The rights of Class A voting shares and Class B voting shares are identical. As a director of the company, Mr. Champ declared and paid dividends on class B voting shares without at the same time declaring and paying dividends on Class A voting shares. The Federal Court of Canada ruled that from the company law principle, there is only one class because Class A and Class B voting shares are identical. It is necessary when creating classes of shares, to create some difference between different classes.
\item\textsuperscript{385} CBCA s. 24(3).
\end{itemize}
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restrictions to shares is to create separate classes.\textsuperscript{386} Furthermore, BCCA talks about attaching different rights or restrictions to shares without specific reference to classes.\textsuperscript{387} Some common law cases support attachment of different rights or restrictions to shares within one class.\textsuperscript{388} Hence in these jurisdictions, it may not be necessary to create different classes in order to attach different rights or restrictions to shares.

PRC Company Law is silent on share classes. As discussed above, PRC Company Law rigidly insists on the equality of share rights without permitting the articles of the company to differentiate share rights in terms of voting, dividends and distribution of surplus on winding up. However, in practice, shares are commonly divided into common and preference shares. Before the promulgation of PRC Company Law, the corporate regulations at both the State and local levels expressly permitted creation of common and preference shares. The Regulating Opinions on Companies Limited by Shares which was the \textit{de facto} company law before PRC Company Law, provide that a company should create common shares and may create preference shares.\textsuperscript{389} The Provisional Regulations of Shenzhen Municipality on Companies Limited by Shares (\textit{Shenzhenshi gufen youxian gongsi zanxing

\textsuperscript{386} BCCA s. 20.

\textsuperscript{387} BCCA ss. 248, 249.

\textsuperscript{388} In \textit{Pender v. Lushington} (1877), 6 Ch. D. 70 (C.A.), a provision in the articles of a company providing that shareholders may not have more than one hundred votes regardless of how many shares they hold is ruled to be valid. In \textit{Bushell v. Faith}, [1970] A.C. 1099 (H.L.), the provision in the articles that gave a director's shares three votes in respect of any resolution to remove him was upheld even though it was obviously designed to frustrate s. 184(1) of the Companies Act of UK then in force, which provided for the removal of a director by ordinary resolution regardless of any contrary provision in the articles.

\textsuperscript{389} Regulating Opinions on Companies Limited by Shares, art. 23.
guiding)\(^{390}\) have similar provisions.\(^{391}\) Furthermore, detailed provisions regarding the preference shares can be found in both regulations.\(^{392}\) These provisions are so detailed and clear-cut\(^{393}\) that, in the context that China was in her experimental stage of share-formulated

\(^{390}\)In *CCH: Special Zones & Cities*, vol. 1, *supra* note 77 ¶ 73-571. These regulations were promulgated by the Shenzhen Municipal People’s Government on March 18, 1992. China had adopted an incremental approach with respect to company law before the promulgation of PRC Company Law in 1993, allowing local areas to issue company legislation that could be implemented on a trial basis or on a small scale in a given location. These Shenzhen Regulations are one example of such legislation. See Torbert, *supra* note 210 at 48.

\(^{391}\)The Provisional Regulations of Shenzhen Municipality on Companies Limited by Shares, art. 51.

\(^{392}\)Ibid.

\(^{393}\)For example, art. 51 of the Provisional Regulations of Shenzhen Municipality on Companies Limited by Shares provides that:

"A company may issue ordinary shares and preference shares.

"Holders of ordinary shares may participate in company administration through the use of their voting rights in shareholders’ meetings, with each share having the equivalent amount of voting rights. After a company has allocated money to its accumulation fund and public welfare fund and paid dividends on preference shares, ordinary shareholders shall have the right to participate in the distribution of the company’s surplus [profits -- author]. Bonuses shall be issued in line with the company’s profit variance. If a company is declared bankrupt or undergoes termination related liquidation procedures, the rights of ordinary shareholders in relation to distribution of the company’s remaining assets shall come after those of company creditors and preference shareholders.

"Holders of preference shares normally shall not be entitled to hold voting rights, but if a company fails to pay dividends for three consecutive years, preference shareholders may also be entitled to voting rights pursuant to the "one share one [vote] "system. Dividends on preference shares shall be paid according to the interest rate or amount stipulated in the articles of association. If a company is declared bankruptcy or undergoes termination-related liquidation procedures, the rights of preference shareholders in relation to distribution of the company’s remaining assets shall come after those of company creditors and before those of ordinary shareholders. A company issuing preference shares shall stipulate in its articles of association provisions on the following items:

“(1) order of assignment of preference share dividends, fixed amount or rate;

“(2) whether the dividends are accumulative or non-accumulative;

“(3) the company’s order of assignment of remaining property to preference shareholders;

“(4) whether or not preference shares may be exchanged for ordinary shares and exchange criteria;

“(5) other matters concerning preference share rights and obligations."
enterprises and had little experience, provided clear directions to the company experiment. Hence many companies established before the promulgation of PRC Company Law created common and preference shares with special rights or restrictions attached. After the promulgation of PRC Company Law, it is difficult for these companies to cancel the issued preference shares. Revising the provisions in the articles regarding the preference shares has proved to be difficult as well due to the reluctance of the existing companies. The extent of the influence of such practice on FICLBS is not clear.

Preference shares, as a flexible financing form, are of wide use in business. Although the common share offerings, particularly initial public offerings, are very popular, preferred share financing remains a fundamental source of corporate finance.\textsuperscript{394} Over the past several years, many Canadian businesses in financial difficulties have refinanced portions of their debt by substituting that indebtedness with what are commonly referred to as “distress preferred shares” because the debtor will enjoy an improved cash flow position by virtue of the after-tax financing nature of distressed preferred shares.\textsuperscript{395} Not able to differentiate rights or


restrictions in respect of shares, companies are greatly limited in terms of the flexibility of corporate financing under PRC Company Law.

It seems that PRC Company Law is a total failure in respect of share classes. In practice, Provisional Regulations of Shenzhen Municipality on Companies Limited by Shares are not revised to comply with the PRC Company Law provisions. These regulations at least enable companies limited by shares in Shenzhen not to cancel their preference shares and revise their articles of incorporation correspondingly. Furthermore, subsequent legislation at the State level also seems to challenge the PRC Company Law. Regulations of the State Council on Foreign Capital Shares Listed in China by Companies Limited by Shares (Guowuyuan guanyu jingnei shangshi waizigu de guiding) refer to “the same type of shares” (tongyi zhonglei gufen) held by holders of A shares and B shares. This reference seems to indicate that separate share classes are still permitted despite the provisions of PRC Company Law. The same regulations further provide that a company may specify in its articles of incorporation any special matters concerning the rights and obligations of its shareholders and make detailed stipulations to that effect. However, Regulations of the State Council on Foreign Capital Shares Listed in China by Companies Limited by Shares were promulgated by the State Council while PRC Company Law was adopted by the Standing Committee of the NPC. The Standing Committee of the NPC is entitled to rescind the regulations enacted by

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397 Ibid. art. 5(2).
the State Council in the case that conflict exists between the legislation separately enacted by them. Hence, even if Regulations of the State Council on Foreign Capital Shares Listed in China by Companies Limited by Shares do imply that companies may create classes among shares, the validity of such implication is in doubt.

The reason for the strict adherence to equality of shares under PRC Company Law is unclear. Perhaps the lawmakers overstate the principle of fairness out of the fear that State owned shares may be prejudiced if different classes of shares are allowed. Another reason for the inconsistency between PRC Company Law and Regulating Opinions on Companies Limited by Shares may be that they were enacted by different legislators. PRC Company Law was enacted by NPC, while the latter Opinions were drafted by the State Commission for Restructuring Economic System.

It is interesting that in China shares are divided into various kinds not by the characteristics of shares but by the status and nationality of shareholders. Shares are divided into State shares, legal person shares, individual shares and foreign capital shares depending upon the principal investment body. State shares refer to those shares purchased with State

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398 PRC Constitution, art. 67(7).

399 Article 130 of PRC Company Law provides that one of the principles that should be followed in the issue of shares is fairness. The protection of State-owned assets is a consistent policy underlying various PRC laws. See art. 2(1), Trial Measures on Share-formulated Enterprises (Gufenzhi qiye shidian banfa) promulgated by the State Commission for Reconstructing Economic System, the State Planning Commission, the Ministry of Finance, the People’s Bank of China and the State Production Office on May 15, 1992, in CCH: Business Regulation, vol. 2, supra note 1 ¶ 13-570; also see art. 4 of the Provisional Regulations on the Administration of the Issuing and Trading of Stocks (Gupiao faxing yu jiaoyi guanli zanxing tiaoli) promulgated 22 April 1993 by the Securities Committee of the State Council, in CCH: Business Regulation, vol. 2, supra note 1 ¶ 13-574.
assets by departments or organs which are authorized to make investments on behalf of the State. Legal person shares refer to those shares purchased with legally allocated funds by legal persons, or shares purchased with the assets of public institutions and social groups which have legal person status and which are authorized by the State to conduct business. Individual shares refer to those shares purchased by individuals with their own legal assets. Shares purchased by foreign investors and investors from Hong Kong, Macao and Taiwan shall be regarded as foreign capital shares. Shares can also be divided into A shares, B shares, H shares and N shares. A shares are available for Chinese domestic investors only. B shares are for foreigners and investors from Hong Kong, Macao and Taiwan. H shares refer to the shares listed on Hong Kong Stock Exchange. N shares refer to the shares listed on New York Stock Exchange. It should be noted that these divisions are only types of shares rather than “classes” in the common law sense because there are no statutory provision requiring that the rights or restrictions attached to these different types of shares shall be different in any respect, let alone the fundamental share rights: dividends, voting and participation of surplus on winding up. In the case of foreign capital shares listed overseas, additional rights are attached.

Shareholders holding such shares representing more than 5% of the voting rights are entitled to raise written proposals to the company for resolution. The items in such proposals which

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400 Trial Measures on Share-formulated Enterprises, art. 4.

401 See Art & Gu, supra note 211 at 301; Wang & Tomasic, supra note 215 at 113; Regulations of the State Council on Foreign Capital Shares in China by Companies Limited by Shares; Special Regulations of the State Council Concerning Floating and Listing of Shares Overseas by Companies Limited by Shares (Guowuyuan guanyu gufen youxian gongsi jingwai muji gufen ji shangshi de tebie guiding) promulgated 4 August 1994 by the State Council, in CCH: Business Regulation, vol. 2, supra note 1 ¶ 13-552.
fall into the jurisdiction of the general meeting shall be included in the agenda of the annual general meeting.\textsuperscript{402} However, such provision does not necessarily create different share classes because these companies may give the same rights to shares held by Chinese domestic investors (including those held by the State). On the contrary, the equality of B shareholders and A shareholders is expressly upheld in the case of companies listed in China.\textsuperscript{403} Therefore, it is erroneous to believe that A, B, H, and N shares are different classes of shares in the common law sense. Such ambiguity has caused great confusion among the Chinese law observers and foreign investors, especially when A shares, B shares, H shares and N shares are commonly translated as “Class A (B, H or N) shares.”\textsuperscript{404} Even some Chinese scholars also seem to believe that A, B, H and N shares are different classes of shares.\textsuperscript{405}

3.2. Par Value and No Par Value Shares

Most common law jurisdictions have abandoned par value shares and only allow the issue of no par value shares. Others permit the co-existence of par and no par value shares. The par value shares were originally introduced to provide some protections to creditors, but proved ineffective. The intent of the par value shares could be circumvented by issuing shares

\textsuperscript{402} Special Regulations of the State Council Concerning Floating and Listing of Shares Overseas by Companies Limited by Shares, art. 21.

\textsuperscript{403} Regulations of the State Council on Foreign Capital Shares Listed in China by Companies Limited by Shares, art. 5.

\textsuperscript{404} See Art & Gu, \textit{supra} note 211 at 301.

\textsuperscript{405} See Wang & Tomasic, \textit{supra} note 215 at 113.
in exchange for property of unproved value.\(^{406}\) The concept of par value shares is arbitrary because share is simply a portion of the interests of the company. Par value shares could be misleading to the purchaser, who might be led to believe that the par value is an indication of the value of his or her investment. Besides that, par value shares generate accounting and disclosure confusion arising from such accounting concepts as "contributed surplus" and "distributable surplus".\(^{407}\)

In those jurisdictions which still allow the issue of par value shares, there is a trend of creating low-par value shares in order to lessen the potential for abuse and has reduced the significance attached to the expression of par value.\(^{408}\)

PRC Company Law permits companies to issue shares at par or at a premium but not at a discount, and no par value shares are not allowed.\(^{409}\) The par value shares serves a host of purposes under PRC Company Law. First, such provision is in conformity with the principle of adequate capitalization of companies under PRC Company Law.\(^{410}\) In China, a system of registered capital is adopted. Registered capital shall be fully paid. Therefore, there is no distinction between registered capital and paid up capital.\(^{411}\) A capital verification certificate

\(^{406}\) B.C. Discussion Paper, supra note 256 at 44.


\(^{408}\) B.C. Discussion Paper, supra note 256 at 44.

\(^{409}\) PRC Company Law, art. 131.

\(^{410}\) Wang & Tomasic, supra note 215 at 113.

\(^{411}\) Ibid. at 79.
shall be submitted to the company registration authority in applying for the registration of the company. Failure of submission may result in refusal to register the company. Variation of the registered capital shall also be registered with company registration authority. The minimum amount of the registered capital of a company limited by shares shall be RMB10,000,000. In the case of FICLBS, the minimum requirement is RMB30,000,000. This reflects the Chinese Government's concern over inadequate capitalization of companies. The policy theory behind these requirements is that when a company has adequate capital, its operations are likely to be smoother and the interests of the public (including the public shareholders and creditors) will not be easily adversely affected. This policy is enhanced by the harsh penalty provisions of both the PRC Company Law and criminal law.

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412 PRC Company Law, art. 94(5).
413 PRC Company Law, art. 95.
414 Administrative Rules of the People’s Republic of China Governing the Registration of Companies, art. 28.
415 PRC Company Law, art. 78.
416 Provisional Regulations on FICLBS, art. 7.
417 Wang & Tomasic, supra note 215 at 79.
418 Article 206 of PRC Company Law provides that: where a company in its application for registration has made a false declaration with regard to its registered capital and has obtained the approval for its registration, it shall be ordered to rectify the wrong doing and subject to a fine equal to five to ten percent (5-10%) of the registered capital falsely declared; where the circumstances are serious, the registration of the company shall be revoked. Where commission of a crime is proved, the person responsible shall be subject to criminal liabilities in accordance with the law.

Article 1 of the Decision of the Standing Committee of the National People’s Congress Concerning Punishment of the Crime Constituting Violation of the Company Law (Quanguo renda changweihui guanyu chengzhi weifan gongsifa fanzui de jueding) adopted 28 February 1995 by the Twelfth Session of the Standing Committee of the Eighth National People’s Congress (in CCH: Business Regulation, vol. 2, supra note 1 ¶ 13-520) provides: when applying for company registration, a person who provides false documentation or adopts other deceptive measures to falsely declare registered capital so as to defraud the Company Registration Authority in order to obtain the
Secondly, Chinese companies may not issue stock for less than par value and shares issued at a premium shall require the approval of the securities authorities of the State Council. These provisions may ensure that all investors pay the same amount per share and hence effect an element of equity. The principle of equity is one of the fundamental principles of share issue under PRC Company Law. Furthermore, the conditions and price of shares issued as part of the same share issue shall be the same. Any entity or individual subscribing to these shares shall pay the same price for each share.

Low par value shares will not have the same effect under PRC Company Law as in Canada. FICLBS have to fulfill the minimum registered share requirement. Besides that, the capital surplus shall be allocated to the capital accumulation fund of the company which shall be used to recover the company’s losses, to expand the production and operation of the company or to increase the registered capital of the company. Unlike common law, the capital surplus is not available of dividends.

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419 PRC Company Law, art. 131.
420 See Art & Gu, supra note 211 at 304.
421 PRC Company Law, art. 130, para. 1.
422 PRC Company Law, art. 130, para. 2.
423 PRC Company Law, arts. 178, 179.
3.3 Going public and flotation

In Canada, as in the UK, the subject concerning going public and flotation is now rightly regarded as a branch of securities regulation rather than company law.\(^{424}\) This belief may account for the failure of coverage of this subject in both federal and provincial company acts in Canada. PRC Company Law refuses to accept the same belief by specifically addressing the subject of going public and flotation.

FICLBS may be established either through the method of promotion or the method of public issue.\(^{425}\) PRC Company Law provides strict restrictions on the public issue. The promoters are not entitled to offer shares to the general public without the approval of the securities authorities of the State Council. For the purpose of approval, the promoters must submit the required documents including the particulars of the promoters, the underwriters and the bank in charge of accepting the subscriptions, the business forecast of the company and the prospectus.\(^{426}\) Hence only upon the approval by the securities authorities of the State Council, shall the prospectus enter into effect and serve as a contract between the issuer and the purchaser. The issuer in question and the purchaser must conduct the transactions in accordance with the terms and conditions of the prospectus. A person distributing a false prospectus shall be ordered to stop issuing such shares and to refund both the money so raised

\(^{424}\) See Gower, Prentice & Pettet, supra note 220 at 311.

\(^{425}\) Provisional Regulations on FICLBS, art. 5.

\(^{426}\) PRC Company Law, art. 84.
and interest on this amount to the subscribers, and shall be subject to a fine of one to five percent (1-5%) of the funds thus raised. Where commission of a crime is proved, criminal responsibilities shall be affixed.\textsuperscript{427} The business forecast letter which is required to be submitted to the securities authorities of the State Council should be carefully drafted in view of the prohibition of submission of false document or the use of other means of deception.\textsuperscript{428} A widely over-optimistic business forecast could well come within this category.\textsuperscript{429}

PRC Company Law has a separate chapter addressing listed companies. The same policy of strict State control is evident in this chapter as well. Both domestic and overseas listings of the shares of FICLBS shall be subject to the approval of the State Council or securities authorities under the State Council.\textsuperscript{430} FICLBS must satisfy five (5) specific conditions in order to be approved for share listing including a history of profitable business of more than three (3) years.\textsuperscript{431} Listed FICLBS are required to regularly and publicly disclose their financial and business situations. A financial accounting report shall be publicized every

\textsuperscript{427} PRC Company Law, art. 90. The criminal responsibilities referred to in this article are detailed in art. 3 of the Decision of the Standing Committee of the National People's Congress Concerning Punishment of the Crime Constituting Violation of the Company Law. A person who issues shares with a false prospectus shall, in cases involving a large amount and entailing serious consequences, or in other serious circumstances, be sentenced to up to five (5) years imprisonment or criminal detention, and may concurrently have a fine imposed of up to five percent (5%) of the funds thus subscribed. A unit (i.e., institutional promoter -- author) which has committed the aforesaid crimes shall be fined up to five percent (5%) of the funds illegally subscribed and the principal personnel directly responsible and other personnel directly responsible shall be sentenced to up to five (5) years imprisonment or criminal detention.

\textsuperscript{428} PRC Company Law, art. 206.

\textsuperscript{429} Wang & Tomasic, \textit{supra} note 215 at 83.

\textsuperscript{430} PRC Company Law, arts. 153, 155.

\textsuperscript{431} PRC Company Law, art. 152.
half year of each fiscal year. The securities authorities of the State Council has the right to suspend or terminate the listing of FICLBS in certain circumstances including three consecutive years of losses.

3.4. Dividends

The profits of a company may be accumulated by the company or paid out, in whole or in part, in the form of dividends. Distributions of the profits of the company among the shareholders in respect of their shares are described as dividends.

Under Canadian law, such distribution is usually made by resolution of the directors declaring a dividend of a certain sum per share or at a rate per cent upon the shares (if they have par value) to be payable on a certain date to shareholders of record as of a specified date subsequent to the date when the resolution is passed. The articles generally empower the directors to declare dividends. Articles of companies incorporated by registration sometimes authorize the declaration of dividends by the company in general meeting, or by the directors with the sanction of a general meeting. Any special regulations as to dividends in the governing act, letters patent, supplementary letters patent, by-laws, memorandum or articles must be observed.

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432 PRC Company Law, art. 156.

433 PRC Company Law, arts. 157, 158.

434 Sutherland, Fraser’s Handbook, supra note 249 at 437.
Two rules have been developed under the common law. First, a company cannot declare dividends if the payment would constitute a return of capital to the shareholders. Paying dividends out of the share capital of a company is prohibited.\textsuperscript{435} Some of the older Canadian acts expressly prohibit the payment of dividends which will impair the capital of the company.\textsuperscript{436} Secondly, as a general rule dividends may not be paid if there are reasonable grounds for believing that the company is, or would be, after the payment, unable to pay its liabilities as they become due or that the realizable value of the company’s assets would be, as a result, less than the aggregate of its liabilities and stated capital of all losses.\textsuperscript{437} This rule has been widely codified in various jurisdictions in Canada.\textsuperscript{438}

Under PRC Company Law, the plans for the distribution of profits and loss recovery of FICLBS are formulated by the board of directors.\textsuperscript{439} Such plans shall be subject to the review and approval of the general meeting by ordinary resolution.\textsuperscript{440} PRC Company Law is silent on the two common law principles, although arguably the approval system of the reduction of

\textsuperscript{435} Verner v. General & Commercial Investment Trust, [1894] 2 Ch. 239 (C.A.).

\textsuperscript{436} Sutherland, Fraser’s Handbook, supra note 249 at 437.

\textsuperscript{437} Ibid.

\textsuperscript{438} These jurisdictions include federal (see s. 42 of CBCA), Alberta (see s. 40 of ABCA), British Columbia (see s. 151(1)(c) of BCCA), Manitoba (s. 40 of Manitoba Companies Act, R.S.M. 1987, c. C 225), New Brunswick (s. 41 of New Brunswick Companies Act, R.S.N.B. 1973, c. C-13), Newfoundland (s. 76 of Newfoundland Companies Act, R.S.N. 1990, c. C-36), Ontario (s. 38(3) of OBCA), Prince Edward Island (ss. 65 and 66 of Prince Edward Island Companies Act, R.S.P.E.I. 1988, c. C-14), Quebec (s. 94 of Quebec Companies Act, R.S.Q. 1977, c. C-38) and Saskatchewan (s. 40 of Saskatchewan Business Companies Act, R.S.S. 1978, c. B-10).

\textsuperscript{439} PRC Company Law, art. 112(5).

\textsuperscript{440} PRC Company Law, arts. 103(7), 106.
the registered capital ensures that share capital of FICLBS will not be impaired by dividends. In contrast to the Canadian company law, PRC Company Law reflects distinctive Chinese characteristics. PRC Company Law controls the allocation of FICLBS' profits and protects specified interests of corporate continuances other than shareholders.  

Under PRC Company Law, FICLBS are required to allocate ten percent (10%) of their annual after-tax profits to the statutory accumulation fund, and five percent (5%) to the statutory welfare fund. The statutory accumulation fund is the ongoing balance of a portion of the company’s profits, minus all of its losses, dividends, and other transfers. The premium income derived from issuing shares at a premium by FICLBS shall be set aside to a special account -- the capital accumulation account. Both the capital and statutory accumulation fund shall be used to recover FICLBS' losses, to expand the production and operation of the FICLBS or to increase the registered capital. Hence the capital surplus is not available for dividends. The statutory accumulation account starts at zero when FICLBS are first organized. When FICLBS suffer business losses, as calculated on its Income Statement (also known as Profit and Loss Statement), the amount will be subtracted from the statutory accumulation fund. The number this calculation produces may be negative. As long as the number remains negative, all future profits must be allocated exclusively to the account. FICLBS are relieved

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441 Art & Gu, supra note 211 at 305.
442 PRC Company Law, art. 177.
443 PRC Company Law, art. 178.
444 PRC Company Law, art. 179.
from the obligation of allocation if the accumulated amount of the statutory accumulation fund has exceeded fifty percent (50%) of the registered capital.\textsuperscript{445} However, no corresponding provision is set out in respect of statutory public welfare funds. This in fact entitles the workers and other personnel who have access to the statutory public welfare funds to 5\%-10\% profits without any shareholding basis. Shareholders may find such provisions unfair and onerous, especially when considering that all FICLBS are usually very large in terms of the amount of capital and the number of shareholders. The regulation of profit allocation is viewed as a reflection of the traditional role Chinese enterprises played in providing life time employment, housing, medical care, retirement, and other social services to their workers. Requirements for welfare funds and the regulation of the use of accumulation funds appear oriented toward maintaining, in some measure, the traditional social functions and responsibilities of enterprises for their workers.

After the mandatory allocations, FICLBS have discretion in distributing their profits. The shareholders may decide to allocate profits to a discretionary accumulation fund -- essentially retaining the profits in the business. Alternatively, remaining profits may be distributed as dividends to shareholders.

III. Summary

\textsuperscript{445} Art & Gu, \textit{supra} note 211 at 305-306. Also see PRC Company Law, art. 177.
In addition to civil law, common law also has great influences on FICLBS in the context of company law. However, FICLBS demonstrate distinctive Chinese characteristics as well. Specific analysis of these characteristics reveals that they are different from each other and rich in kind. Due to the lack of a clear definition, Chinese characteristics may be randomly explained. This contributes to the uncertainty of the future of FICLBS.
CHAPTER V  CONCLUSION

Since Deng Xiaoping took power in 1978, China has been exercising the policy of opening up to the outside world, the purpose of which is to join the world economy. It culminated in China's application for rejoining the GATT in 1986. For this purpose, various measures are taken to make China meet the requirements of GATT and WTO and comply with international practice. As a result, China permits foreign access to its domestic prime securities market which accounts for the permission of establishment of FICLBS. Among other results, China has been exercising national treatment to foreign investment enterprises in order to create a better investment environment. China is also reforming its domestic enterprise system with the purpose of compliance with international practice. All of the above policies have significant influences on FICLBS. On the other hand, China has always been trying to maintain the so-called Chinese characteristics despite the fact that there is no generally accepted definition of Chinese characteristics.

FICLBS are a product of the above policies. The different effects of different policies make FICLBS a contradiction in various senses.

In the context of foreign investment law, FICLBS are based on the Old Foreign Investment Regime. FICLBS are governed by the legal provisions relating to foreign investment regime. Therefore, FICLBS shall be subject to the differential treatments enjoyed by foreign investment enterprises. Although China is in the process of exercising national treatment and has been cancelling some preferential treatments of foreign
investment enterprises, there exists a substantial amount of tax and other preferential treatments available to foreign investment enterprises. The foreign investment nature of FICLBS avails FICLBS to such treatments. In the meantime, foreign investment enterprises are subject to special State administration and control. In order for FICLBS to comply with those legal provisions applicable to them, it is also necessary to make clear what are legal provisions governing foreign investment regime and how they apply to FICLBS. Unfortunately, the provisions of foreign investment enterprises are very complicated and inconsistent in some aspects. Furthermore, it is difficult to define what are foreign investment enterprises. Hence this thesis proposes a few rules about how to apply foreign investment legal provisions to FICLBS. At the same time, various State and Party policies give various characteristics to FICLBS and make them different from other foreign investment enterprises. As a result of foreign access to China's prime securities market, the scope of investors of FICLBS is much broader than the three other forms of foreign investment which exclude Chinese individual investors. Permission of Chinese individuals and individual businesses to participate in FICLBS is significant to FICLBS because of the increasing financial strength of Chinese individuals and individual businesses. Such funds constitute an integral and important financing source for FICLBS. As a result of national treatment, FICLBS enjoy all the four forms available to foreign investment enterprises and domestic enterprises respectively. Land use rights have always been a big issue to foreign investment enterprises because in China all the land is owned by the State or collectively owned. The availability of all the four forms of land use rights gives FICLBS much
flexibility in selecting the land use form. However, the inherent problems with the land use system in China are not resolved. As a result of maintaining Chinese characteristics, the approval system of FICLBS is quite different from that of the other foreign investment forms. FICLBS do not adopt the multi-level approval system governing other foreign investment enterprises. FICLBS are subject to the final approval of MOFTEC as a result of strict State control. This solves many problems with the multi-level approval system such as *ultra vires* approval and delegation of approval authority. Approval process is the beginning of FICLBS. A clear-cut and succinct approval system will surely benefit foreign investors of FICLBS. With regard to dissolution, the dissolution regime of FICLBS does not mandate liquidation in the cases of merger, dissolution and buyout. This is a development from the Old Foreign Investment Regime which unnecessarily requires liquidation in the above cases. The evaluation of assets is an integral part of the dissolution. FICLBS regime is silent on this issue. Investors have to make detailed provisions in the articles of association of FICLBS. In sum, on one hand FICLBS are based on and develop the Old Foreign Investment Legal Regime. On the other hand FICLBS demonstrate their own characteristics and present their own problems.

In the context of company law, FICLBS are greatly influenced by both common law and civil law as a result of the policy of joining the world economy. There are much literature on the civil law influence on China’s company legislation. But little attention is paid to the common law. In fact, common law also has substantial influence on FICLBS. The influence of common law on FICLBS is manifest in various respects including
incorporation, corporate liability, corporate governance, shares, etc. On the other hand, various Chinese characteristics are intentionally remained. These Chinese characteristics can be found in many phases and aspects of FICLBS. This thesis tries to reveal these characteristics through review of the corporate capacity, corporate governance, shares and dividends of FICLBS. With regard to corporate capacity, the *ultra vires* doctrine is remained in China as a part of the State’s efforts to control the activities of FICLBS so that they comply with State policies and plans. With regard to corporate governance, the shareholders’ meeting is the supreme authority within FICLBS although the exercising of powers on the part of the shareholders has to rely heavily on the directors. FICLBS are represented by their respective legal representatives. As the management of FICLBS, the directors bear fiduciary duties to the company but are restricted by the public and employees’ interests to a limited extent. With regard to shares and dividends, China does not expressly permit differentiating shares into different classes. Besides that, only par value shares are permitted to be issued and no par value shares are prohibited. These Chinese characters make FICLBS different from the companies limited by shares in the Western legal regimes. They find their roots in social, historical, political and cultural factors of China. Both foreign investors and foreign scholars may be unfamiliar with these characteristics because they are unique to China. Many of such characteristics are reflected in important aspects of FICLBS including corporate capacity, corporate management, shares and dividends. Therefore, this thesis devotes efforts to reveal and analyse these Chinese characteristics.
The policy basis of FICLBS determines that FICLBS will be inevitably affected by the change of the Party and State policies in the process of China’s further reform and opening up although China has always been trying to assure foreign investors that China will keep its policies consistent.\textsuperscript{446} However, within the policies underlying FICLBS such as the Chinese characteristics to be maintained, some of them (\textit{e.g.}, legal representative) are so deeply rooted in the history and other factors of China that they are unlikely to be changed easily and within a short time. While issues such as the problem of land use rights deriving from the rigid implementation of national treatment should be able to be solved without much difficulty because both the land use legal regime and the national treatment policy are of a much short history and do not have deep social and economic roots.

However, FICLBS, as a new form of investment available to foreign investors, are significant in terms of permitting foreign access to China’s primary securities market through issuing shares to the public and listing in domestic stock exchanges. Before the permission of FICLBS, foreign investors are only allowed to trade B shares issued by Chinese domestic enterprises. FICLBS are an important step forward in the process of China’s opening up. It seems that no matter how specific policies are changed, the basic policy of openness and joining the world economy will not be

\textsuperscript{446} For example, Deng Xiaoping reiterated for several times that “there is no need to worry that our policies might change” in a 73-page thin book. See Deng Xiaoping, \textit{Build Socialism with Chinese Characteristics}, supra note 29 at 53, 55, 61.
changed in the near future.447 If the opening process is not reversed, FICLBS will always be available for foreign investors who intend to invest in China no matter how the specific FICLBS legal regime is restructured and changed.

447 Adherence to reform and openness is provided as one of the fundamental principles of China in the Constitution of PRC together with Four Cardinal Principles. See Amendment to PRC Constitution, art. 3.
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