

CHINA'S NEW COOPERATIVE JOINT VENTURE LAW

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In the decade since the People's Republic of China (PRC) began opening its doors to foreign investment in the late 1970s, several vehicles have been developed through which foreign firms may invest in the PRC to undertake manufacturing or service projects. The first vehicle to be officially offered to foreigners as a means for investment was the "equity" joint venture (EJV), which was given its legislative basis in a brief 1979 statute,¹ since supplemented by detailed implementing regulations² and substantial other legislation.³ The EJV is a limited liability⁴ joint venture company formed

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1. Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Fa, in ZHONGGUO SHEWAI JINGJI FAGUI HUIBIAN, 1949-1985, at 849 [hereinafter ZSJFH] (The Law of the People's Republic of China on Chinese-Foreign Joint Ventures) (adopted July 1, 1979, promulgated July 8, 1979) [hereinafter Joint Venture Law] (trans. in 1 CHINA'S FOREIGN ECONOMIC LEGISLATION 1 (1982)) [hereinafter CFEL:1].

2. Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Fa Shishi Tiaoli, in ZSJFH, *supra* note 1, at 853 (Regulations for the Implementation of the Law of the People's Republic of China on Chinese-Foreign Joint Ventures) (promulgated Sept. 20, 1983) [hereinafter Implementing Rules] (trans. in 3 CHINA'S FOREIGN ECONOMIC LEGISLATION 1 (1987)) [hereinafter CFEL:3].

3. See, e.g., Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Dengji Guanli Banfa, in ZSJFH, *supra* note 1, at 885 (Procedures of the People's Republic of China for the Registration and Administration of Chinese-Foreign Joint Ventures) (promulgated July 26, 1980) (trans. in CFEL:1, *supra* note 1, at 13); Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Laodong Guanli Guiding, in ZSJFH, *supra* note 1, at 877 (Provisions of the People's Republic of China for Labor Management in Chinese-Foreign Joint Ventures) (promulgated July 26, 1980) [hereinafter JV Labor Provisions] (trans. in CFEL:1, *supra* note 1, at 20); Zhongwai Hezi Jingying Qiye Laodong Guanli Guiding Shishi Banfa, in ZSJFH, *supra* note 1, at 880 (Provisions for the Implementation of the Regulations on the Labor Management of Joint Ventures Using Chinese and Foreign Investment) (promulgated Jan. 19, 1984) [hereinafter JV Labor Implementation Provisions] (trans. in China Econ. News, Mar. 12, 1984, at 2); Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Kuaiji Zhidu, in ZSJFH, *supra* note 1, at 902 (The Accounting Regulations of the People's Republic of China for Joint Ventures Using Chinese and Foreign Investment) (promulgated Mar. 4, 1985) (trans. in China Laws For Foreign Business ¶ 35-500 (CCH Australia Limited Ed.)) [hereinafter CLFB]; Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Caiwu Guanli Guiding, in FAGUI XINXI 34 (1987) (Provisions of the People's Republic of China for Financial Management in Chinese-Foreign Joint Ventures) (promulgated Aug. 5, 1986); Zhongguo Yinhang Dui Waishang Touzi Qiye Daikuan Banfa (Procedures of the Bank of China for Loans to Enterprises with Foreign Investment) [hereinafter BOC Loan Procedures], in ZHONGHUA RENMIN GONGHEGUO GUOWUYUAN GONGBAO 359 (1987) (STATE

by one or more Chinese enterprises with one or more foreign entities for a specified period of time,⁵ pursuant to a joint venture contract, articles of association and related documents. The parties make contributions in cash and/or in kind⁶ to the joint venture company's registered capital in an agreed upon ratio⁷ and share profits, losses and distributions upon dissolution in accordance with that ratio.⁸ The joint venture company is treated as a "legal person" under Chinese law⁹ and pays taxes,¹⁰ signs contracts and

COUNCIL GAZETTE OF THE PEOPLE'S REPUBLIC OF CHINA) [hereinafter STATE COUNCIL GAZETTE] (approved Apr. 7, 1987, promulgated Apr. 24, 1987) (trans. in E. ASIAN EXEC. REP., Sept. 1987, at 24); Zhonghua Renmin Gongheguo Waihui Guanli Zanzing Tiaoli, in ZSJFH, *supra* note 1, at 744 (Interim Regulations on Foreign Exchange Control of the People's Republic of China) (adopted Dec. 5, 1980, promulgated Dec. 18, 1980) (trans. in CFEL:1, *supra* note 1, at 118); Dui Qiaozi Qiye, Waizi Qiye, Zhongwai Hezi Jingying Qiye Waihui Guanli Shixing Xize, in ZSJFH *supra* note 1, at 772 (Rules for the Implementation of Foreign Exchange Controls Relating to Overseas Chinese Enterprises, Foreign Enterprises and Chinese-Foreign Joint Ventures) (approved July 19, 1983, promulgated Aug. 1, 1983) (trans. in 2 CHINA'S FOREIGN ECONOMIC LEGISLATION 230 (1986)) [hereinafter CFEL:2]; Guowuyuan Guanyu Zhongwai Hezi Jingying Qiye Waihui Shouzhi Pingheng Wenti de Guiding, in STATE COUNCIL GAZETTE *supra* at 66 (1986) (Provisions of the State Council on the Question of the Balance of Foreign Exchange Receipts and Expenditures of Chinese-Foreign Joint Ventures) (promulgated Jan. 15, 1986) (trans. in E. ASIAN EXEC. REP., Feb. 1986, at 26) [hereinafter Foreign Exchange Provisions]; Guanyu Zhongwai Hezi Jingying Qiye Zhuce Ziben Yu Touzi Zonghe Bili de Zanzing Guiding, in STATE COUNCIL GAZETTE *supra*, at 215 (1987) (Interim Provisions Concerning the Ratio between Registered Capital and Total Amount of Investment of Chinese-Foreign Equity Joint Ventures) (promulgated Mar. 1, 1987) (trans. in E. ASIAN EXEC. REP., Mar. 1987, at 22) [hereinafter Debt-Equity Ratio Provisions]; Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Suode Shui Fa, in ZSJFH, *supra* note 1, at 619 (Income Tax Law of the People's Republic of China Concerning Chinese-Foreign Joint Ventures) (adopted Sept. 10, 1980) (trans. in CFEL:1, *supra* note 1, at 36) [hereinafter JVITL]; Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Suode Shui Fa Shixing Xize, in ZSJFH, *supra* note 1, at 622 (Rules for the Implementation of the Income Tax Law of the People's Republic of China Concerning Chinese-Foreign Joint Ventures) (approved Dec. 10, 1980, promulgated Dec. 14, 1980) (trans. in CFEL:1, *supra* note 1, at 45) [hereinafter JVITL Rules].

4. Joint Venture Law, *supra* note 1, art. 4; *see also* Implementing Rules, *supra* note 2, art. 19.

5. Joint Venture Law, *supra* note 1, art. 12; *see also* Implementing Rules, *supra* note 2, art. 100.

6. Joint Venture Law, *supra* note 1, art. 5; *see also* Implementing Rules, *supra* note 2, art. 25.

7. Joint Venture Law, *supra* note 1, art. 4; *see also* Implementing Rules, *supra* note 2, arts. 14, 16. Article 14 of the Implementing Rules lists an agreed upon ratio of capital contributions as a mandatory clause in an EJV contract while Article 16 requires that such ratio appear in the joint venture's articles of association.

8. Joint Venture Law, *supra* note 1, art. 4; *see also* Implementing Rules, *supra* note 2, art. 106.

9. Implementing Rules, *supra* note 2, art. 2; *see also infra* notes 24 and 25 and accompanying text.

10. *See generally* Joint Venture Law, *supra* note 1, art. 7; Implementing Rules, *supra* note 2, arts. 69-72; JVITL, *supra* note 3, art. 1.

undertakes other legal and economic activities in the name of the company and not in the names of the joint venture parties.

At the same time as the first Sino-foreign equity joint ventures were being established, Chinese investment officials raised the possibility of wholly foreign-owned enterprises (FOEs) in the PRC. In the early 1980s, a number of small-scale solely foreign enterprises of uncertain legal status were established, primarily by Hong Kong investors, in the special economic zones of the PRC's southern Guangdong Province.¹¹ In 1986, FOEs were given a legal mandate with the publication of a law¹² that lays down some basic ground rules for these enterprises but leaves their corporate legal status somewhat unclear.¹³

Meanwhile, since the early 1980s, one of the most popular forms of investment by foreign companies in the PRC has been one for which no formal legal basis existed until earlier this year. Various known as the "cooperative" or "contractual" joint venture (CJV), this investment vehicle seems to have developed not by specific design of the Chinese authorities but as an ad hoc reaction to some of the obstacles the EJV form has posed to the achievement of certain business objectives. For instance, foreign companies which want for a variety of reasons to take out a larger percentage of a joint venture's profits than their contribution to the project's capital would justify have been able to achieve this

11. The 1980 regulations governing the three special economic zones (SEZs) in Guangdong Province allowed foreign investors to set up wholly foreign-owned enterprises in the SEZs without elaborating in any way on the nature or legal status of such enterprises. See Guangdong Sheng Jingji Tequ Tiaoli, in ZSJFH, *supra* note 1, at 947 (Regulations on Special Economic Zones in Guangdong Province) (approved Aug. 26, 1980) (trans. in CFEL:1, *supra* note 1, at 193) [hereinafter Guangdong SEZ Regulations], art. 1.

12. The Law of the People's Republic of China Concerning Wholly Foreign-Owned Ventures (Zhonghua Renmin Gongheguo Waizi Qiye Fa) (adopted Apr. 12, 1986) (trans. in CLFB, *supra* note 3, ¶ 13-506) [hereinafter FOE Law].

13. The FOE Law makes clear that it is not intended to cover "branches" in China of foreign enterprises but only enterprises that are "established within the territory of China in accordance with the relevant laws of China and whose entire capital is invested by foreign investors". FOE Law, *supra* note 12, art. 2. The PRC does not yet have a company law that defines such concepts as "branch" and "subsidiary." In some respects, the PRC's concept of a FOE seems akin to the Western notion of a wholly-owned foreign subsidiary. The tax treatment of FOEs, however, is inconsistent with this characterization, since FOEs are taxed as "establishments" of foreign enterprises rather than as discrete Chinese corporate entities. See Zhonghua Renmin Gongheguo Waiguo Qiye Suode Shui Fa, in ZSJFH, *supra* note 1, at 640 (Income Tax Law of the People's Republic of China Concerning Foreign Enterprises) (adopted Dec. 13, 1981) (trans. in CFEL:1, *supra* note 1, at 64) [hereinafter FEITL], art. 1; see Gelatt, *Tax Guide*, CHINA BUS. REV. Nov-Dec. 1987, at 18, 25. This tax anomaly may soon be rectified as part of a general reform of the PRC's tax laws for foreign investment enterprises.

goal with a CJV. In the CJV format, as it has developed through practice over the last several years, the foreign and Chinese investors may agree in the joint venture contract on the percentages of profit split for each party, and these percentages may vary over the life of the contract.

As of early 1989, about 7000 CJV contracts had been concluded between Chinese and foreign entities, as opposed to about 9000 EJV's.¹⁴ EJV's only recently began to overtake CJVs in terms of the numbers of contracts concluded - in early 1988, CJV's led EJV's by about 600 contracts.¹⁵ Yet, although CJVs were covered in numerous pieces of PRC legislation on tax,¹⁶ customs duties,¹⁷ contracts,¹⁸ and national and local rules to encourage foreign investment,¹⁹ until the promulgation on April 13, 1988 of the Law of

14. Conservation of Gelatt colleague with official of Ministry of Foreign Economic Relations and Trade, Beijing, March 24, 1989.

15. As of mid-1984, 1372 CJVs were established whereas only 362 EJV's had been established in China. China Econ. News, Nov. 12, 1984, at 2.

16. See generally, FEITL, *supra* note 13, art. 1.

17. See, e.g., Haiguan Zongshu, Caizheng Bu, Duiwai Jingji Maoyi Bu Guanyu Zhongwai Hezuo Jingying Qiye Jinchukou Huowu de Jianguan he Zhengmian Shui Guiding, in ZSJFH, *supra* note 1, at 141 (Provisions of the General Administration of Customs, the Ministry of Finance and the Ministry of Foreign Economic Relations and Trade Concerning the Supervision of, and the Imposition of or Exemption from Tax on, Imports and Exports by Chinese-Foreign Cooperative Enterprises (promulgated Jan. 31, 1984) (trans. in CFEL:3, *supra* note 2, at 178).

18. See, e.g., Zhonghua Renmin Gongheguo Shewai Jingji Hetong Fa, in ZSJFH, *supra* note 1, at 1205 (Foreign Economic Contract Law of the People's Republic of China) (promulgated Mar. 21, 1985) (trans. in CLFB, *supra* note 7, ¶ 5-570) [hereinafter FECL].

19. Guowuyuan Guanyu Guli Waishang Touzi de Guiding, in STATE COUNCIL GAZETTE, *supra* note 3, at 757 (1986) (Provisions of the State Council of the People's Republic of China for the Encouragement of Foreign Investment) (promulgated Oct. 11, 1986) (trans. in E. ASIAN EXEC. REP., Nov. 1986, at 22) [hereinafter 22 Articles]. As of December 1987, eleven implementing regulations have been issued under the 22 Articles, with more expected: Guanyu Waishang Touzi Qiye Yongren Zizhuquan he Zhigong Gongzi, Baoxian Fuli Feiyong de Guiding, in STATE COUNCIL GAZETTE, *supra* note 3, at 959 (1986) (Provisions Concerning the Right of Autonomy of Enterprises with Foreign Investment in Hiring Personnel and the Wages, Insurance and Welfare Costs of Staff and Workers) (promulgated Nov. 10, 1986) (trans. in E. ASIAN EXEC. REP., Jan. 1987, at 25); Zhonghua Renmin Gongheguo Haiguan Dui Waishang Touzi Qiye Luxing Chanpin Chukou Hetong Suoxu Jinkou Liaojian Guanli Banfa, in STATE COUNCIL GAZETTE, *supra* note 3, at 960 (1986) (Procedures of the Customs of the People's Republic of China for the Administration of Materials and Parts that Enterprises with Foreign Investment Need to Import in order to Carry Out Product Export Contracts) (promulgated Nov. 24, 1986) (trans. in E. ASIAN EXEC. REP., Jan. 1987, at 23); Zhongguo Renmin Yinhang Guanyu Waishang Touzi Qiye Waihui Diya Renminbi Daikuan Zanxing Banfa, STATE COUNCIL GAZETTE, *supra* note 3, at 25 (1987) (Interim Procedures Concerning Renminbi Loans to Enterprises with Foreign Investment Secured by Foreign Exchange) (promulgated Dec. 12, 1986) (trans. in E. ASIAN EXEC. REP., Jan. 1987, at 25); Caizhengbu Guanche Guowuyuan Guanyu Guli Waishang Touzi de Guiding Zhong Shuishou Youhui Tiaokuan de Shishi Banfa, in STATE COUNCIL GAZETTE, *supra* note 3, at 93 (1987)

the PRC on Chinese-Foreign Cooperative Joint Ventures (the CJV Law),²⁰ no national counterpart to the 1979 law on equity joint ventures or the 1986 law on wholly foreign-owned enterprises existed to define the nature of a CJV or set forth its organizational structure.

As the following analysis of some of the important provisions of the CJV Law will demonstrate, the new statute does little to change the status quo for CJVs as it has developed through prac-

(Implementing Measures of the Ministry of Finance to Implement the Tax Preference Articles of the Provisions of the State Council for the Encouragement of Foreign Investment) (promulgated Jan. 31, 1987) (trans. in E. ASIAN EXEC. REP., Feb. 1987, at 25); Duiwai Jingji Maoyibu Guanyu Waishang Touzi Qiye Goumai Guonei Chanpin Chukou Jiejue Waihui Shouzhi Pingheng de Banfa, in STATE COUNCIL GAZETTE, *supra* note 3, at 118 (1987) (Measures of the Ministry of Foreign Economic Relations and Trade for Enterprises with Foreign Investment to Solve the Balance of Foreign Exchange Receipts and Expenditures by Purchasing Domestic Products for Export) (promulgated Jan. 20, 1987) (trans. in E. ASIAN EXEC. REP., Feb. 1987, at 24) [hereinafter Product Export Measures]; Duiwai Jingji Maoyi Bu Guanyu Waishang Touzi Qiye Shenqing Jinchukou Xukezheng de Shishi Banfa, in STATE COUNCIL GAZETTE, *supra* note 3, at 119 (1987) (Implementing Measures on the Application by Enterprises with Foreign Investment for Import and Export Licenses) (promulgated Jan. 24, 1987) (trans. in E. ASIAN EXEC. REP., Feb. 1987, at 24); Duiwai Jingji Maoyi Bu Guanyu Queren he Kaohe Waishang Touzi de Chanpin Chukou Qiye he Xianjin Jishu Qiye de Shishi Banfa, in STATE COUNCIL GAZETTE, *supra* note 3, at 120 (1987) (Implementing Measures of the Ministry of Foreign Economic Relations and Trade for the Confirmation and Examination of Export Enterprises and Technologically Advanced Enterprises with Foreign Investment) (promulgated Jan. 27, 1987) (trans. in E. ASIAN EXEC. REP., Feb. 1987, at 26); Debt-Equity Ratio Provisions, *supra* note 3; BOC Loan Procedures, *supra* note 3; Jingnei Jigou Tigong Waihui Danbao de Zanxing Guanli Banfa, in STATE COUNCIL GAZETTE, *supra* note 3, at 157 (1987) (Interim Measures for the Administration of the Provision of Foreign Exchange Guaranties by Domestic Institutions) (promulgated Feb. 20, 1987) (trans. in E. ASIAN EXEC. REP., Mar. 1987, at 21); Guanyu Zhongwai Hezi, Hezuo Jingying Qiye Chanpin Yi Chan Dingjin Banfa (Measures Concerning the Use of Products of Chinese-Foreign Equity and Cooperative Joint Ventures for Import Substitution) (promulgated Oct. 19, 1987) (trans. in Ta Kung Pao, Nov. 5, 1987) [hereinafter Import Substitution Measures].

For examples of local regulations implementing the 22 Articles, see Shanghai Shi Guanyu Guli Waishang Touzi de Ruogan Guiding (Provisions of Shanghai Municipality for the Encouragement of Foreign Investment) (effective Nov. 1, 1986) (trans. in ELIASOPH, LAW AND BUSINESS PRACTICE IN SHANGHAI 6 (1987)); Beijing Shi Renmin Zhengfu Guanyu Shishi Guowuyuan Guanyu Guli Waishang Touzi de Guiding de Ruogan Guiding (Certain Provisions of the Beijing Municipal People's Government Concerning the Implementation of the Provisions of the State Council for the Encouragement of Foreign Investment) (promulgated Oct. 11, 1986); Guangzhou Shi Guli Waishang Touzi de Shishi Banfa (Provisions of the Municipal Government of Guangzhou for the Encouragement of Foreign Investment) (promulgated Nov. 3, 1986); Guangzhou Jingji Jishu Kaifaqu Guli Waishang Touzi de Shishi Banfa (Implementing Measures of the Guangzhou Economic and Technological Development Zone for the Encouragement of Foreign Investment) (promulgated Dec. 15, 1986).

20. Zhonghua Renmin Gongheguo Zhongwai Hezuo Jingying Qiye Fa (The Law of the People's Republic of China on Chinese-Foreign Cooperative Joint Ventures) in Renmin Ribao (People's Daily), April 16, 1988, at 2 (adopted Apr. 13, 1988) (trans. in E. ASIAN EXEC. REP., May, 1988, at 7) [hereinafter CJV Law].

tice. Foreign investors who expected clear answers to the many legal questions posed by CJVs will be disappointed in the new law; but by the same token, those who feared that the law's promulgation would limit some of the negotiating freedom the CJV form has afforded will be reassured. In many respects, the CJV Law is a model of legislated flexibility.

The most vexing legal question posed by CJVs has always been their corporate legal status — or lack thereof. When the investment form first began to appear, many projects seemed to Western lawyers to resemble a partnership arrangement, with the Chinese and foreign investors retaining their separate legal identities rather than forming a distinct joint venture company as in the case of EJVs. The PRC's corporate tax laws governing foreign business and investment activity backed up this analysis of CJVs, by taxing the foreign company involved in a CJV separately on its profits from the venture,²¹ with the Chinese investor paying tax on its benefits under separate domestic tax legislation.²²

By the early 1980s, however, an alternative form of CJV had begun to emerge that appeared to afford investors the best of both worlds — the flexibility on profit sharing and other aspects that the CJV form provides, and the protection of a limited liability joint venture company. These "equity-type" or "type A" CJVs, as they were variously called, looked for all the world like EJVs, but, by virtue of being designated CJVs in the contract, were not subject to the restrictions of the laws and regulations governing EJVs. In some cases, equity-type CJV's were taxed as entities, rather than the partners' being taxed separately as in the "normal" CJV situation.²³

The CJV Law tacitly confirms that CJVs may take two different forms by providing that a "cooperative venture which meets the provisions of Chinese law regarding the conditions for being a

21. Zhonghua Renmin Gongheguo Waiguo Qiye Suode Shui Fa Shishi Xize, in ZSJFH, *supra* note 1, at 644 (Rules for the Implementation of the Income Tax Law of the People's Republic of China Concerning Foreign Enterprises) (promulgated Feb. 21, 1982) [hereinafter FEITL Rules] (trans. in CFEL: 2, *supra* note 3, at 83), art. 3.

22. Chinese state enterprises are increasingly being subject to income tax and allowed to keep all or a large part of their after-tax profits, rather than simply turning all their profits over to the state as they had previously been required to do. For discussion of these and other domestic tax reform efforts, see Wang Chuanlun, *Some Notes on Tax Reform in China*, 97 CHINA Q. 53 (1984); Hsiao, *Is Fiscal Policy Keeping Pace with Economic Reform?*, E. ASIAN EXEC. REP., Dec. 1986, at 16.

23. The relevant tax legislation allows for this possibility. Cooperative venture partners are to pay tax separately in the absence of "separate stipulations" by the tax authorities. FEITL RULES, *supra* note 21, art. 3.

legal person will acquire the status of a Chinese legal person in accordance with law." The concept of a "legal person," which China inherits from its continental law tradition, is defined in the PRC's 1986 General Principles of Civil Law²⁴ as describing an organization that possesses the capacity for civil rights and civil acts, independently enjoying civil rights and assuming civil responsibilities.²⁵ To gain legal person status, an EJV, CJV or FOE must be registered with the appropriate authorities and (1) be formed in accordance with the relevant PRC law; (2) have the necessary property or funds; (3) have its own name, organization and site; and (4) be capable of assuming civil liability independently.²⁶

The CJV Law provides no guidance on how the parties to a CJV contract may go about ensuring either that their CJV will be treated as a separate legal entity or that it will not. Indeed, after raising the possibility in the above-cited provision that non-legal entity, partnership-type CJVs may still be formed under the new law, the statute goes on to treat registration, taxation, labor, financing, insurance and other issues as if these matters were all to be handled on an enterprise basis, i.e., as if CJVs were all to be treated as legal persons.²⁷ For instance, all CJVs are apparently required to have articles of association, a term which connotes a legal entity structure.²⁸ Still, both the CJV Law and the comments of leading PRC investment officials on the new statute²⁹ indicate that it is possible for the parties to specify explicitly in the contract that a non-legal person format is intended, and for such a provision to be effective upon approval of the PRC investment authorities.

One issue that the new law does not address at all is limited liability. In the past, some foreign companies forming "equity" or legal person-type EJVs have been able to write a limited liability concept into their contracts, and have these provisions approved, thereby presumably imbuing the investors in the CJV by contract

24. Zhonghua Renmin Gouheguo Minfa Tongze, 1987 Law Year Book of China 68 (1987)(the General Principles of Civil Law of the People's Republic of China) (promulgated April 12, 1986) [hereinafter Civil Law Principles] (trans. in 13 REV. OF SOC. LAW 357 (1987)) arts. 36, 37.

25. *Id.* art. 37.

26. *Id.* arts. 37, 41.

27. See generally CJV Law, *supra* note 20, arts. 5-7, 11-21.

28. See *id.* at arts. 5, 11, 12; Civil Law Principles, *supra* note 24, art. 41.

29. [Deputy Bureau Chief of the Foreign Investment Bureau of the Ministry of Foreign Economic Relations and Trade] Chu Baotai Explains the Cooperative Joint Venture Law, Wen Wei Bao (Hong Kong), May 3, 1988, at 31 [hereinafter Chu Baotai].

with the same limited liability afforded EJV parties by law.³⁰ By not mentioning the point, the CJV Law drafters cannot be assumed to have intended to exclude the possibility of limited liability for CJV parties. Article 2 of the law, which confirms the "contractual" nature of CJVs by giving the parties complete freedom to negotiate the distributions of earnings and the sharing of risks and liabilities,³¹ would appear to leave room for the contractual establishment of limited liability.³²

In addition to legislating the contractual flexibility the parties to CJVs have always enjoyed with respect to the division of profits and losses, the CJV Law also gives legal confirmation to an approach some companies have used to help solve the perennial problem of foreign exchange balancing in Sino-foreign joint ventures,³³ namely, the taking of profits by the foreign partner in products produced by the joint enterprise rather than in cash,³⁴ an approach not available in the case of EJVs. Although this "compensation trade"³⁵ method poses a number of practical and legal problems, not the least of which is arriving at an appropriate valuation of the products, it may be an effective solution for companies that are able to make profitable use of the Chinese-produced products in their own operations or for resale on the international market.

The other major respect in which CJVs have afforded investors a greater degree of flexibility than EJVs relates to the forms in

30. See Joint Venture Law, *supra* note 1, art. 4; Implementing Rules, *supra* note 2, art. 19.

31. See CJV Law, *supra* note 20, art. 2, which reads, "[i]n establishing a cooperative venture, the Chinese and foreign cooperative venturers shall, in accordance with the provisions of this Law, reach agreement in a cooperative venture contract on such matters as the investment or conditions for cooperation, the distribution of earnings or products, the sharing of risks and losses, the manner of operation and management and the ownership of the property upon termination of the cooperative venture."

32. A leading PRC foreign investment official has stated that, under the new CJV Law, if a CJV publishes its registered capital and declares itself to be a limited liability company, it will enjoy limited liability. Chu Baotai, *supra* note 29.

33. CJV Law, *supra* note 20, art. 20 states the standard proposition that CJVs should resolve the balance of foreign exchange receipts and expenditures on their own, though it allows for the possibility of applying to relevant authorities for assistance, "in accordance with State provisions," if a CJV cannot resolve the balance on its own. A number of pieces of PRC legislation provide possible means of assistance to both equity and cooperative ventures to obtain foreign exchange. See, e.g., Foreign Exchange Provisions, *supra* note 3; Product Export Measures, *supra* note 19; Import Substitution Measures, *supra* note 19.

34. CJV Law, *supra* note 20, art. 2.

35. For a brief discussion of compensation trade in the PRC, see Cohen and Valentine, *Foreign Direct Investment in the PRC: Progress, Problems and Proposals*, 1 J. CHINESE L. 182 (1987).

which the parties may contribute to the capital of the enterprise. Contributions to the "registered capital" of an EJV may take the form of cash, equipment, technology or industrial property rights, and, in the case of the Chinese party only, the right to use of the site³⁶ on which the joint venture will have its operating facilities.³⁷ The term "registered capital" has typically not been used for CJVs — even those of an "equity" nature — but the parties are nonetheless required to agree on what assets each party will offer up to establish the enterprise. In a number of CJVs, the Chinese investor has used the labor force as a "contribution," handling recruitment and payment of the Chinese personnel needed for the project entirely on its own, rather than making this a joint venture obligation as is required in the case of EJVs.³⁸ Also, CJVs have not typically been subject to the informal and in some cases formal guidelines that restrict the percentage of a foreign party's contribution to an EJV that can take the form of intangibles such as know-how and technology.³⁹

The new law follows the trend developed in practice by referring not to "contributions to capital" but rather to "investment or conditions for cooperation,"⁴⁰ and seems generally to confirm the pre-existing flexibility on this subject. Although labor is not specif-

36. Under the PRC Constitution, land is owned by the "State" or "collectives" and may not be owned by individuals or particular enterprises. *Zhonghua Renmin Gongheguo Xianfa* in ZSJFH, at 1, (Constitution of the People's Republic of China) (adopted Dec. 4, 1982) (trans. in *Beijing Review*, Dec. 27, 1982, at 13), art. 10. However, the "right to use of land" in the form of leaseholds of varying terms may be "owned" by enterprises and, under a recent constitutional amendment, transferred. *Zhonghua Renmin Gongheguo Xianfa Xiuzheng* in *Renmin Ribao, Haiwai Ban* (People's Daily, Overseas Edition) April 13, 1988, at 3 (Amendment to the Constitution of the People's Republic of China) (adopted April 12, 1988), art. 2. See also notes 43 and 44, *infra*, and accompanying text.

37. Joint Venture Law, *supra* note 1, art. 5.

38. See JV Labor Provisions, *supra* note 3; see also *JV Labor Implementation Provisions*, *supra* note 3.

39. In the Guangzhou Economic and Technological Development Zone and the Shenzhen Special Economic Zone, local regulations restrict contributions of technology or know-how to twenty percent of an EJV's total registered capital, and require foreign investors to match technology contributions with an equivalent amount of cash or tangible assets. Guangzhou Jingji Jishu Kaifaqu Jishu Yinjin Zanzing Guiding, in ZSJFH, *supra* note 1, at 1075 (Interim Regulations of the Guangzhou Economic and Technological Development Zone Concerning the Introduction of Technology) (promulgated Apr. 9, 1985) (trans. in *China Econ. News*, June 17, 1985, at 2), art. 12; Shenzhen Jingji Tequ Jishu Yinjin Zanzing Guiding, in ZSJFH, at 1001 (Interim Provisions of the Shenzhen Special Economic Zone for the Import of Technology) (adopted Jan. 11, 1984, promulgated Feb. 8, 1984) (trans. in *CFEL*:3, *supra* note 4, at 334), art. 23. Similar guidelines of an "internal" and informal nature are often cited in negotiations in other PRC cities. See Gelatt, *Legal and Extra-Legal Issues in Joint Venture Negotiations*, 1 *J. CHINESE L.* 232, 233 & nn. 55, 56 (1987).

40. See, e.g., CJV Law, *supra* note 20, arts. 2, 8.

ically mentioned as a possible “condition for cooperation,” a general catch-all — “and other property rights” — could possibly be interpreted to cover it, and a leading PRC legal official has confirmed that it will.⁴¹ The law adds an interesting alternative to the options open to foreign investors by allowing either the Chinese or the foreign side to bring site use rights to the enterprise.⁴² Foreign enterprises may now purchase leases to plots of land for varying periods pursuant to legislation in Shanghai,⁴³ Shenzhen⁴⁴ and other parts of China and could use these as contributions to CJVs under the new law.

One traditional difference between CJVs and EJVs that has always seemed to be more one of form than substance has been that, while EJVs are required by law to establish a board of directors,⁴⁵ CJVs typically are run by a “joint management committee” with representatives from each party. The new CJV Law gives the parties a choice between having a board of directors or a joint management organ. The law also adds an element of flexibility unavailable in the EJV context by allowing either the Chinese or the foreign partner to provide the chairman of the board or joint management organ, requiring only that, whichever party assumes the chairmanship, the other party have the right to appoint the deputy. Under the EJV Law as it currently stands, the Chinese party has the sole right to appoint the chairman and the foreign party the vice-chairman,⁴⁶ though a revision to this rule is currently under consideration.⁴⁷

On taxation, the new law is a model of vaguery. Article 21 states simply that “cooperative ventures shall pay taxes in accordance with State provisions regarding taxation and may also enjoy preferential treatment of reduction of and exemption from

41. Statement of PRC investment official to author's colleague in Hong Kong, May 1988.

42. See CJV Law, *supra* note 20, art. 8.

43. Shanghai Shi Tudi Shiyongquan Youchang Zhuanrang Banfa, in China Econ. News, Jan. 25, 1988, at 2 (Measures of Shanghai Municipality on Paid Transfer of The Right of Use of Land) (promulgated Nov. 29, 1987) (trans. in *id.* at 8).

44. Shenzhen Tudi Zhaobiao Toubiao Shixing Banfa, in China Econ. News, Dec. 28, 1987, at 16 (Provisional Measures on Invitation of Tenders and Submission of Tenders Concerning Land Sale in Shenzhen) (effective Nov. 14, 1987) (trans. in *id.* at 8).

45. Joint Venture Law, *supra* note 1, art. 6; Implementing Rules, *supra* note 2, arts. 33, 34.

46. Joint Venture Law, *supra* note 1, art. 6.

47. Comment of PRC investment official to author's colleague in Hong Kong, May 1988.

taxes.”⁴⁸ The implication that a CJV is to pay tax as an enterprise is confusing in light of the typical practice discussed above,⁴⁹ but more likely reflects inaccurate drafting than a change in policy.⁵⁰ The reference to unspecified preferential treatment may be fleshed out in the implementing regulations that will eventually be issued under the CJV Law.⁵¹ Under the various legislation that has been promulgated on a central and local level in the PRC in the last couple of years to encourage foreign investment,⁵² and under the legislation governing the PRC's special economic zones⁵³ and fourteen coastal cities earmarked for foreign investment,⁵⁴ all types of “foreign investment enterprises” - EJVs, CJVs and FOEs - are

48. CJV Law, *supra* note 20, art. 21.

49. *See supra* notes 21, 22 and accompanying text.

50. A PRC investment official has indicated that, under the CJV Law, the parties will continue to be taxed separately under separate legislation. Chu Baotai, *supra* note 29.

51. It is difficult to predict when the implementing rules for the CJV Law will be promulgated. In the case of Joint Venture Law, *supra* note 1, its Implementing Rules, *supra* note 2, were issued in Sept. 1983, over 4 years after the Joint Venture Law was first adopted in July 1979. The greater degree of experience the PRC has accumulated since those early years in both the drafting and implementation of investment legislation should enable implementing rules for the CJV Law to emerge somewhat more rapidly.

52. *See, e.g.*, the legislation cited in *supra* note 19.

53. *See* Zhonghua Renmin Gongheguo Guowuyuan Guanyu Jingji Tequ he Yanhai Shishi Ge Gangkou Chengshi Jianzheng, Mianzheng Qiye Suode Shui he Gongshang Tongyi Shui de Zanxing Guiding, in ZSJFH, *supra* note 1, at 1030 (Interim Provisions of the State Council of the People's Republic of China Concerning the Reduction of and Exemption from Enterprise Income Tax and Consolidated Industrial and Commercial Tax in the Special Economic Zones and Fourteen Coastal Port Cities) (promulgated Nov. 15, 1984) (trans. in CFEL:3, *supra* note 2, at 239) [hereinafter SEZ/14 Cities Provisions]; *see also* Guangdong SEZ Regulations, *supra* note 11.

54. *See* SEZ/14 Cities Provisions, *supra* note 53. for local legislation governing the various economic and technological development zones in the coastal cities; *see, e.g.*, Dalian Jingji Jishu Kaifaqu Ruogan Youhui Daiyu de Guiding, in ZSJFH, *supra* note 1, at 1043 (Provisions for Preferential Treatment in Dalian Economic and Technological Development Zone) (promulgated Oct. 15, 1984) (trans. in China Econ. News, Dec. 10, 1984, at 1) [hereinafter Dalian ETDZ Provisions]; Guangzhou Jingji Jishu Kaifaqu Zanxing Tiaoli, in ZSJFH, *supra* note 1, at 1066 (Interim Regulations on Guangzhou Economic and Technological Development Zone) (promulgated April 9, 1985) (trans. in China Econ. News, June 10, 1985, at 1) [hereinafter Guangzhou ETDZ Regulations]; Guangzhou Jingji Jishu Kaifaqu Gongshang Shuishou Shishi (Shixing) Banfa, in ZSJFH, *supra* note 1, at 1087 (Provisional Procedures for the Implementation of Industrial and Commercial Taxes in the Guangzhou Economic and Technological Development Zone) (promulgated April 9, 1985) (trans. in China Econ. News, July 1, 1985 at 3) [hereinafter Guangzhou ETDZ Tax Procedures]; Ningboshi Jingji Jishu Kaifaqu Zanxing Tiaoli, in ZSJFH, *supra* note 1, at 1109 (Provisional Regulations for the Economic and Technological Development Zone in Ningbo Municipality) (adopted June 15, 1985) (trans. in China Econ. News (Supp. No. 1), Jan. 20, 1986, at 1) [hereinafter Ningbo ETDZ Regulations]; Tianjin Jingji Jishu Kaifaqu Guanli Tiaoli, in ZSJFH, *supra* note 1, at 1128 (Regulations on the Tianjin Economic and Technological Development Zone) (adopted July 20, 1985) (trans. in China Econ. News, Aug. 19, 1985, at 1) [hereinafter Tianjin ETDZ Regulations].

granted identical tax advantages in terms of possible lowered tax rates, additional tax holidays, and certain exemptions from import and export taxes and duties.⁵⁵ Under China's national tax legislation, however, which applies in the absence of any special local or national legislation on point,⁵⁶ investors in CJVs fare considerably worse on tax benefits than those in EJVs, paying generally higher tax and being entitled to tax holidays only in rare circumstances.⁵⁷ The PRC is currently reforming its tax system for foreign investment with the aim of formulating one comprehensive tax law to govern all foreign investment enterprises, affording each type of venture equivalent rates and benefits.

Under the legislation governing EJVs, it is not permitted for the foreign investor to recover its capital investment *per se* during the term of the company.⁵⁸ When an EJV's term expires, the law provides for a liquidation process in which, theoretically, the foreign party receives its proportional share of the equity after payment of the company's debts.⁵⁹ The CJV Law, in keeping with past practice, allows the parties to negotiate a provision under which the foreign investor recovers its investment during the term of the project and all assets then belong to the Chinese party upon expi-

55. See SEZ/14 Cities Provisions, *supra* note 53, arts. I(1), (2), (5), (6), II(1), (2), (5), (6), III(1), (2), (4), (5); see also Guangdong SEZ Regulations, *supra* note 11, arts. 1, 13, 14, 16; Dalian ETDZ Provisions, *supra* note 54, arts. 1, 3-7, 12-15, 18-21; Guangzhou ETDZ Regulations, *supra* note 54, arts. 3, 12-16, 18; Guangzhou ETDZ Tax Procedures, *supra* note 54, arts. 3-5, 7-11, 16; Ningbo ETDZ Regulations, *supra* note 54, arts. 4, 7-9, 11, 12, 14, 15; Tianjin ETDZ Regulations, *supra* note 54, arts. 24, 25, 27, 28, 31, 32, 34.

56. Compare FEITL, *supra* note 21, arts. 3, 4 (graduated income tax rates of 30% to 50% including local income tax) with JVITL, *supra* note 3, art. 3 (providing for a fixed rate of 33%, inclusive of local surtax, for EJVs).

57. Compare FEITL, *supra* note 13, art. 5 (granting a tax exemption of one year and fifty percent tax reduction for two years only to foreign enterprises operating for 10 years or more in farming, forestry, animal husbandry or other "low-profit operations") with JVITL, *supra* note 3, art. 5, as amended by Quanguo Renmin Daibiao Dahui Changwu Weiyuanhui Guanyu Xiugai Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Suode Shui Fa de Jueding, in CFEL:2, *supra* note 3, at 306 (Decision of the Standing Committee of the National People's Congress Concerning Revision of the Income Tax Law of the People's Republic of China Concerning Chinese-Foreign Joint Ventures) (adopted Sept. 2, 1983) (trans. in *id.* at 304), art. 1 (providing a two-year tax holiday and three further half-rate tax years for all EJVs scheduled to operate for at least 10 years).

58. The JV Implementing Rules prohibit the reduction of the registered capital of a joint venture during its term. JV Implementing Rules, *supra* note 2, art. 22. The PRC tax authorities regard the early recovery of a foreign investor's investment as the reduction of registered capital. See Caizhengbu Guanyu Zhongwai Hezi Jingying Qiye Guding Zichan Zhejiang Shiyong Fanwei de Guiding, in Caizheng (Finance), No. 1, 1986, at 47 (Provisions of the Ministry of Finance Regarding the Scope of Use of Depreciation of Fixed Assets by Chinese-Foreign Joint Ventures) (adopted Nov. 11, 1985).

59. Implementing Rules, *supra* note 2, art. 106.

ration.⁶⁰ If such investment is to be recovered before the payment of tax on CJV profits, as has been negotiated in a number of projects in the past, the approval of the tax authorities must be obtained in advance.⁶¹

A provision of the CJV Law on which interpretation is sorely needed is one providing that, when the agreement provides for the foreign party to recover its investment during the term of the venture, "the Chinese and foreign cooperative venturers shall, in accordance with the provisions of relevant laws and the agreements in the cooperative venture contract, assume responsibility for the liabilities of the cooperative venture."⁶² The concern lying behind this provision is clear, namely, the need to ensure that CJV creditors are appropriately protected in the situation where the capital of the "enterprise" has been effectively reduced. But the law gives no clue as to how the drafters intend for this problem to be solved. The implication seems to be that the foreign party will retain some responsibility, even after it has withdrawn its investment. Will the parties be entirely free to agree in the contract how this responsibility will be determined? No "relevant laws" promulgated thus far appear to provide any guidance.⁶³

Whether or not the foreign party has recovered its investment prior to expiration of the venture term, the CJV Law provides for a "liquidation" or expiration similar to that stipulated for EJVs.⁶⁴ Like the EJV legislation, the law neither specifically mentions nor explicitly precludes the possibility, rather than "liquidating" the enterprise, of the Chinese party's buying out the foreign party's interest. This is an approach many foreign investors find fairer than liquidation in light of the fact that the Chinese party will in most cases continue to carry on the business independently after expiration of the joint venture contract and continue to benefit from the accumulated know-how and good will derived over the

60. CJV Law, *supra* note 20, art. 22.

61. *Id.*

62. *Id.*

63. One leading PRC investment official has suggested that the parties may agree in the contract on how to share debts after the foreign party has withdrawn its investment, but that the foreign investor must provide security of some kind for such debts. Chu Baotai, *supra* note 29. Another official has suggested that the foreign investor in this situation may be required to return the portion of the investment it has recovered to satisfy joint venture debts, but would not be liable beyond that amount. Comment of PRC investment official to author's colleague, Hong Kong, May 1988.

64. CJV Law, *supra* note 20, art. 24. For the rules on EJV liquidation, see Implementing Rules, *supra* note 24, arts. 102-108.

years from the foreign party's participation.⁶⁵ Just as many foreign companies have been able to negotiate buy-out clauses in EJV contracts, presumably, under the CJV Law, investors will be able to agree on similar arrangements despite the silence of the law, and enforce them upon governmental approval.

The CJV Law, like the EJV Law and the law on FOEs before it, indicates that ventures are expected to have a fixed term but provides no guidelines on what are acceptable periods.⁶⁶ As with EJVs, this issue will no doubt be covered in the implementing regulations.⁶⁷ CJVs have tended in the past to have shorter terms than EJVs, in part because of the nature of operations for which the CJV form has frequently been employed — hotels and other foreign-exchange earning service projects in which the foreign partner is allowed to recover its investment and the Chinese party to take over sole ownership as soon as possible.

While neither Chinese nor foreign investors are eager to think about disputes when just entering into an investment relationship, potential participants in CJV contracts will want to take cognizance of the new law's provisions on dispute resolution, which differ in an interesting way from the comparable rules for EJVs. The EJV legislation requires that, before the parties may take a dispute to arbitration, they must attempt to resolve the matter through "friendly consultations."⁶⁸ The CJV Law allows the parties to submit a dispute directly to arbitration - inside or outside of China - if they "do not want to resolve the matter through consultation or mediation."⁶⁹ This provision - consistent with one in the PRC Foreign Economic Contracts Law that governs all Chinese-foreign contractual arrangements⁷⁰ - reflects a new Chinese awareness that, while informal inter-party dispute resolution is still to be encouraged, it may in some cases be preferable to take a serious problem straight to a neutral forum to have it resolved expeditiously.

The CJV Law follows in the now almost ten-year tradition of

65. See Gelatt, *supra* note 39, at 246, 247.

66. See CJV Law, *supra* note 20, art. 25.

67. Compare Implementing Rules, *supra* note 2, art. 100; as revised by Guanyu Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Fa Shishi Tiaoli Di Yibai Tiao de Xiuding, in STATE COUNCIL GAZETTE, *supra* note 3, at 68 (1986) (issued Jan. 15, 1986) (trans. in CFEL:3, *supra* note 2, at 33).

68. Joint Venture Law, *supra* note 1, arts. 6, 14; Implementing Rules, *supra* note 2, art. 109.

69. CJV Law, *supra* note 20, art. 26.

70. FECL, *supra* note 18, art. 37.

PRC foreign economic statutes by painting a broad outline and leaving many issues unanswered. The implementing regulations and other supplementary rules and interpretations that will gradually emerge should answer many of these questions. The basic domestic company law being prepared by the PRC may shed light on some of the basic corporate legal points left open by the new law. As more and more projects are negotiated and concluded, foreign investors and lawyers will find no substitute for the ever-accumulating body of practical experience being established by both Chinese and foreign enterprises. Though difficult to document, the large number of investment ventures of all types⁷¹ already operating in the PRC, and those still being developed, serve as a kind of informal "common law," as the provision one company negotiates and has approved becomes a precedent for another company. Given the still incomplete nature of statutory law - particularly for CJVs - practice, as a popular Chinese catch phrase puts it, remains in many cases the sole criterion of truth.

71. See text accompanying *supra* note 14; compare Cohen & Valentine, *supra* note 35, at 179.