China Law, Tax & Accounting

Giovanni Pisacane

Corporate Governance in China

The Structure and Management of Foreign-Invested Enterprises Under Chinese Law

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ISSN 2365-628X ISSN 2365-6298 (electronic)
China Law, Tax & Accounting
ISBN 978-981-10-3910-2 ISBN 978-981-10-3911-9 (eBook)
DOI 10.1007/978-981-10-3911-9

Library of Congress Control Number: 2017933938

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Printed on acid-free paper

This Springer imprint is published by Springer Nature
The registered company is Springer Nature Singapore Pte Ltd.
The registered company address is: 152 Beach Road, #21-01/04 Gateway East, Singapore 189721, Singapore

To my beloved kids Isabella and Federico Kai

Preface

In an effort to become more attractive to foreign investment, China has initiated reforms to both unify and clarify corporate governance structures, targeting inconsistencies and eliminating uncertainty. In particular, the reform seeks to incubate an environment for foreign investors in which there are clear, stable, transparent and well-defined legal boundaries. China is, therefore, ever aware that its approval-based system requires updating to remain competitive and inviting.

Fundamentally, an essential factor for the success of investors and professionals engaging in business in China is being able to understand and correctly set up a sustainable and effective corporate governance structure. However, the Chinese legislation regulating corporate entities is continuously evolving, and whilst many improvements may be found, gaps still exist in the code as a result of a lack of interpretation and the need for further definitions. Consequently, one can see many doubts and uncertainties that practitioners and entrepreneurs are left to deal with when structuring business and ensuring compliance.

In order to provide some assistance with clarity for foreign investors, the focus of this text is on the corporate governance of PRC foreign-invested enterprises, rather than purely domestic PRC companies, i.e. companies totally owned by Chinese individuals or entities. It should be noted that this differentiation has been eroded by the proposed reform of company law, purposed on unifying, to a certain extent, the discipline of foreign-invested companies and domestic companies.

For the time being, several marked differences still exist between the two types of company; therefore, as we have written this book principally for foreign investors approaching the Chinese market or looking to improve their existing corporate structures, we have chosen to focus on corporate governance for foreign-invested companies.

We have examined some of the most frequent questions posed by investors based on our decadelong experience in which we have assisted in the set-up of foreign-invested companies and have been appointed as supervisors or members of the board of supervisors. This volume is not meant as an academic book, but rather as a guide for handling company issues on a daily basis, ranging from the simplest activities to the most complex operations.

As such, we have examined company structures, their functions, and the relevant liabilities, with some practical and operational observations. We have included a chapter on shareholders' agreements to further examine the structuring of corporate decisions. In addition, we have dedicated an ad hoc chapter to the use of company seals (so-called chops) and their relevance in the day-to-day handling of a company.

I also would like to express my gratitude to Mrs. Tina Yang for her great cooperation and effort in helping me to write this book and all GWA lawyers team that contributed in terms of time and ideas for this book.

Shanghai, China

Giovanni Pisacane
Lawyer, Managing Partner of GWA Shanghai

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Chapter 1
Sources of Law on Corporate Governance

This book focuses on the governance structure of Limited Liability Companies' in respect of the Shareholders (or the Board of Shareholders), Executive Director (or Board of Directors), Supervisor (or Board of Supervisors) and Senior Management Personnel and respectively equipping the governance structure with the power, duties, balance and supervisory elements. The following Chapter will firstly present the past developments (Sect. 1.1) and the present situation of Chinese corporate governance legislation (Sects. 1.2 and 1.3); we will then analyze an important reform project on foreign-invested enterprises currently under discussion (Sect. 1.4); finally, we will provide a brief overview of the main organs and authorities that regulate corporate governance in China (Sect. 1.5).

1.1 Historical Remarks

The origins of modern Chinese corporate governance can be found as far back as the latter years of the Qing Dynasty, yet laws regarding this subject matter were actually applied much later, in the years of the Republic of China, ruled by the Kuomintang (1912–1949).

Since the foundation of the People's Republic of China, various approaches to the regulation of companies have succeeded one another. The nearly seventy years of history of socialist China's corporate law have been schematically divided into four phases: *dominance of state-owned enterprises* (1949–1983), *separation of government and enterprises* (1984–1992), *experiments for a modern corporate structure* (1993–2005), *efforts towards improving corporate governance* (from 2006 until the present day).[1]

Simply put, in the last thirty years, the process of reform and opening-up has contributed to four main changes within the Chinese corporate environment.

[1]Yong et al. (2008).

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G. Pisacane, *Corporate Governance in China*, China Law, Tax & Accounting, DOI 10.1007/978-981-10-3911-9_1

The Chinese economy has moved from a state-owned enterprise focus to one based on privately owned enterprises, with the former still having a very important role.

Many state-owned enterprises have been transformed into privately owned corporations (so-called *corporatization* of state-owned enterprises) however, whilst their corporate governance has gradually been removed from the decisions of the central and local governments, they can still experience interferences and pressure from government authorities. Following the (re)opening of stock exchanges in 1990, a flourishing, albeit strictly controlled, securities market has developed alongside a continually strengthening Foreign Investment scene.

1.2 The Company Law and Corporate Governance Principles

In order to regulate the companies' organization and activities and protect the legal interest of the companies, shareholders and creditors, the Standing Committee of the National People's Congress of the People's Republic of China (the Standing Committee of NPC) conceived the 1993, *Company Law of the People's Republic of China* (Company Law). However, in spite of the good intentions behind the Law, it was not sufficient to support company developments, particularly in respect of the corporation governance, thus in the years 1999 and 2004, the Standing Committee of NPC conducted 2 minor modifications to the *1993 Company Law*.

Yet, even with the new modifications, the Law could not solve the problems incurred during the development of the modern companies. Subsequently, on 27th October 2005, the Standing Committee of NPC carried out a profound revision on *1993 Company Law* in order to optimize the corporation governance for the companies incorporated in China, accordingly, the revised version of *Company Law* in 2005 entered into force on 1st January 2006. Aimed at lowering the threshold for access to the market, on 28th December 2013, a new Amendment to *Company Law* was promulgated and entered into force on 1st March 2014, given this Amendment's purpose, it does not involve any reform on the corporation governance.

Company Law is a general law governing the companies' matters including the corporation governance, it applies to the Limited Liability Companies (LLCs) and Companies Limited by Shares (CLSs) registered in China. Given *Company Law (revised in 2005)*'s significance in enhancing corporation governance, it is worth introducing its novelties.

The *2005 Amendment to Company Law* introduced a number of provisions on corporate governance, the most noteworthy of which are the protections for the minority shareholders' rights, protection, and guarantee of rights to information, and it further bolstered the concept of abuse of a shareholder rights with the codification of piercing the corporate veil. Moreover, in many instances, it finally provided a much-needed definitional update of the corporate organs' duties, rights, and liabilities.

One of these new functions was Article 33 of *Company Law (revised in 2005)* which provides that shareholders have the right of access to corporate information. In particular, the Article sets out the right to examine the company's articles of association and the accounting books as well as the minutes of the meetings of corporate organs. Within this, the Law also made provisions for the justiciability of the right, granting shareholders the avenue to commence legal action with the People's Court where such rights are denied.

Additionally, the Law introduced a measure to counter the abusing of shareholders' rights, resulting in the loss of limited liability for abusers. According to Article 20, "*Where a shareholder abuses their rights, thereby causing a loss to the company or to other shareholders, such a shareholder shall be liable for compensation according to the law*."

The same Article, in its second paragraph, goes on to codify lifting the corporate veil to expose such abuse: "*Where a shareholder abuses the independent status of the company as a legal person and the limited liability of shareholders to evade debts and seriously damage the interests of the company's creditors, he shall bear joint and several liability for the debts of the company*".

Furthermore, Under Article 21 of *Company Law (revised in 2005)*, "*The controlling shareholder, de facto controller, the directors, the members of the board of supervisors and the senior officers of a company may not use their affiliation to harm the interests of the company*".

As it can be seen, these norms provide for so-called piercing of the corporate veil, resulting in the loss of limited liability, as a consequence of the abuse of shareholders' rights. These provisions provide a potentially powerful tool for retaliation by a company against any shareholder that damages said company through abusing their rights, facilitating an added layer of protection from majority shareholder power.

At the other end of the spectrum, in regards to minority shareholders' rights, Article 103 of *Company Law (revised in 2005)* provides minority shareholder protection remedies: a shareholder or shareholders representing at least 3% of the capital of a company may submit an interim proposal to the board of directors ten days before a general meeting is held. The directors must communicate such an extraordinary resolution to the shareholders' general meeting. Article 100 gives the shareholder or the shareholders representing at least 10% of the capital the ability to convene an extraordinary shareholders' meeting. Under Article 75 of *Company Law (revised in 2005)*, where a shareholder has expressed an opposing vote to certain decisions of a shareholders' meeting, he has the right to transfer his shares to the company for a reasonable price. The ramifications of this Article for the Capital Maintenance Doctrine are considered later.

Given that this Book is focusing on the corporation governance of the LLCs, as a summary, we need to know that *Company Law* has established the mandatory governance structure for the LLCs in China as below:[2]

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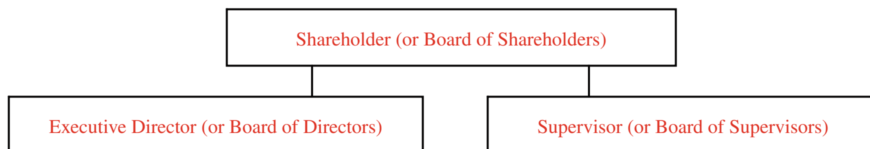
[2]Under Article 61 of *Company Law*, a single shareholder limited liability company shall have no board of shareholders. Under Article 50, Limited liability companies with a smaller number of



Notwithstanding that *Company Law* provides the mandatory governance structure set forth above, it is worth mentioning that *Company Law* also provides a clause stipulating that laws of the foreign-invested company shall apply where they have special provisions. Accordingly, the foreign-invested LLCs in China can exhibit a diverse mandatory governance structure (please see Sect. 1.3).

Apart from the mandatory governance structure, it is common to equip the LLCs' governance structure with the managers and other senior management personnel, particularly, although *Company Law* does not require that the LLCs shall set up the managers, in practice, the competent Corporation Registration Authority (Administration of Market Supervisor) has the discretion to require the LLCs to register the name of general manager along with the information of the mandatory governance structure in the process of the LLCs Incorporation Registration. In respect of the LLCs' governance structure's establishment and relevant power and duties, the Chapters hereinafter will introduce.

Although the *2013 Amendment to Company Law* did not contain any reform on corporation governance, rather it introduced certain novelties in respect of registered capital,[3] we need to know that the current version of *Company Law*, which is composed of 13 chapters and 218 articles in total, is the revised version of 2013, accordingly, hereinafter the quoted clauses in *Company Law* are referring to those in Company Law (revised in 2013).

From a comparative perspective, Chinese Company Law is today a mixture of Anglo-Saxon and continental European legal elements. The duty of care and duty of loyalty of directors and high-level officers of a company is derived from the experience of common law jurisdictions and, more precisely, from the law of the United Kingdom. The possibility for shareholders to commence a derivative action against the directors is also similar to the Anglo-American system.

(Footnote 2 continued)

shareholders or those of a smaller scale may have an Executive Director without setting up the Board of Directors. Under Article 51, a limited liability company shall have the Board of Supervisors composed of no less than three members. Limited liability companies with a smaller number of shareholders or those of a smaller scale may have one to two supervisors without setting up the Board of Supervisors.

[3]The *2013 Amendment to Company Law* established the Subscribed Capital Registration System, which generally abolished the requirements on the minimum registered capital, maximum capital contribution term and minimum percentage of monetary contribution unless otherwise provided by any special laws and regulations. Accordingly, the shareholders in general are free to decide the upon these terms in the Articles of Association.

On the other hand, the existence of a supervisory board is close to the civil law model. More precisely, this feature is drawn from the German model, through the intermediation of Japanese corporate law. As a result of the hybrid nature of the Chinese system, it is important to understand the ramifications for Chinese corporate governance, particularly in regards to foreign-invested companies. In order to assess and explain these measures, we will systematically identify and evaluate each important element of the code and then we will progress to the Draft Law.

1.3 The Foreign-Invested Enterprises Laws

The expression "Foreign-Invested Enterprises" defines the companies established under PRC laws in which at least one non-PRC entity has made an investment by participating to their capitalization. In total, there are 3 different foreign-invested enterprises as below:

A. Wholly Foreign-Owned Enterprise (WFOE)

WFOE refers to the enterprise invested in by the foreign entity and the foreign entity can be the foreign natural person or legal person or other economic entities (excluding the branches established in China-mainland by the foreign entities). The legal form of a WFOE shall be a limited liability company, or, subject to approval, another form of liability.

B. Sino-foreign Equity Joint Ventures (EJV)

EJV refers to the enterprise invested in by both a foreign entity and a Chinese entity, and the foreign entity can be a foreign natural person or legal person or other economic entities (excluding the branches established in China-mainland by the foreign entities). Yet, in principle the Chinese entity cannot be a Chinese natural person but a Chinese legal person or other economic entities, particularly, the Chinese natural person can be one of the shareholders in EJV in 2 common circumstances as follows: (a) EJV is incorporated in the area where enjoying special policy allowing the Chinese natural person to be one of the shareholders in EJV, such as China(Shanghai) Pilot Free Trade Zone; (b) EJV is incorporated by means of the foreign investor acquiring part of the shareholdings in a domestic company which was invested by the Chinese natural person. The legal form of an EJV shall be a limited liability company.

C. Sino-foreign Cooperative Joint Ventures (CJV)

In common with the EJV, CJV also refers to the enterprise invested by both foreign entity and Chinese entity, and the foreign entity can be a foreign natural person or legal person or other economic entities (excluding the branches established in China-mainland by the foreign entities), however, in principle the Chinese entity

cannot be a Chinese natural person but the Chinese legal person or other economic entities.

In terms of the legal form, unlike the EJV, the CJV can be the limited liability company or any other form which are not defined as non-enterprise legal person; in terms of profit distribution, unlike the EJV in which the profit is distributed in proportion to the shareholders' actual paid-in capital, normally the profit of the CJV is distributed according to the specific agreement between the parties.

Currently, apart from Company Law, respectively, the WFOE is specially regulated by *Law of the People's Republic of China on Wholly Foreign-Invested Enterprises* (last amended in 2016, hereinafter referred to as WFOE Law) and its Implementation Rule, the EJV is specially regulated by *Law of the People's Republic of China on Equity Joint Ventures* (last amended in 2016, hereinafter referred to as EJV Law) and its Implementation Rule, and CJV is specially regulated by *Law of the People's Republic of China on Wholly Foreign-Owned Enterprises* (last amended in 2016, hereinafter referred to as CJV Law) and its Implementation Rule.[4]

[4]On 3rd September 2016, the Standing Committee of the 12th National People's Congress of the People's Republic of China adopted the decision to revise the foreign-invested enterprises laws, subject to this Decision, *Law of the People's Republic of China on Wholly Foreign-owned Enterprises*, *Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures*, *Law of the People's Republic of China on Sino-Foreign Cooperative Joint Ventures* as below:

I. Revisions to the Law of the People's Republic of China on Wholly Foreign-owned Enterprises A new article shall be added as Article 23: "Where the establishment of wholly foreign-owned enterprises does not involve the implementation of special access administrative measures prescribed by the state, the approval items stipulated in Article 6, Article 10 and Article 20 of this Law are subject to record-filing management. The special access administrative measures prescribed by the state shall be promulgated by or approved for promulgation by the State Council."

II. Revisions to the Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures A new article shall be added as Article 15: "Where the establishment of Chinese-foreign equity joint ventures does not involve the implementation of special access administrative measures prescribed by the state, the approval items stipulated in Article 3, Article 13 and Article 14 of this Law are subject to record-filing management. The special access administrative measures prescribed by the state shall be promulgated by or approved for promulgation by the State Council."

III. Revisions to the Law of the People's Republic of China on Sino-Foreign Cooperative Joint Ventures A new article shall be added as Article 25: "Where the establishment of Chinese-foreign cooperative joint ventures does not involve the implementation of special access administrative measures prescribed by the state, the approval items stipulated in Article 5, Article 7, Article 10, Paragraph 2 of Article 12 and Article 24 of this Law are subject to record-filing management. The special access administrative measures prescribed by the state shall be promulgated by or approved for promulgation by the State Council."

In terms of the corporation governance, the corporation structure of the 3 different foreign-invested enterprises vary from each other subject to WFOE Law or EJV Law or CJV Law as below:

A. WFOE's Organization Structure

Given that WFOE Law and the Implementation Rule do not provide special clauses in respect of the components of the WFOE's organization structure, the WFOE shall apply 2013 Company Law to set its organization structure. In other words, the WFOE shall exhibit the mandatory organization structure as below: Shareholder (or Board of Shareholders) + Executive Director (or Board of Directors) + Supervisor (or Board of Supervisors).

B. EJV's Organization Structure

According to EJV Law and its Implementation Law, unlike the mandatory organization structure subject to 2013 Company Law, the EJV does not have the Board of Shareholders, instead, it shall exhibit the mandatory organization structure as below: Board of Directors + Supervisor (or Board of Supervisors).

C. CJV's organization Structure

According to CJV Law and the Implementation Rule, unlike the mandatory organization structure subject to 2013 Company Law, the EJV does not have the Board of Shareholders as well, instead, in the case of the CJV in the legal form of limited liability company, in common with the EJV, it shall exhibit the mandatory organization structure as below: Board of Directors + Supervisor (or Board of Supervisors); in the case of the CJV in the legal form of non-Enterprise Legal Person, it shall set up the Co-Management Committee. Particularly, subject to the unanimous consent of the Board of Directors or the Co-Management Committee, the CJV can entrust a third party to handle its operation and management per a written contract.

Furthermore, in terms of the corporation governance of the foreign-invested enterprise in China, apart from the WFOE Law and EJV Law and CJV Law and their Implementation Rules, we also need to refer to the *Catalogue for the Guidance of Foreign Investment Industries (Revised in 2015, hereinafter referred to as 2015 Catalogue)*[5] and check whether there are requirements on the shareholding percentage and senior management to the foreign investment in question. Specifically, please see the below table:

[5]2015 Catalogue classifies the foreign investment into the "Encouraged Foreign Investment" and "Restricted Foreign Investment" and "Forbidden Foreign Investment", as for the foreign investment not mentioned in 2015 Catalogue, those are defined as "Allowed Foreign Investment".

No.	Catalogue of encouraged industries for foreign investment		Restricted measures
1	Exploration and exploitation of oil and natural gas (including oil shale, oil sands, shale gas, coal-bed methane and other unconventional oil and gas), and utilization of mine gas		Limited to equity/cooperative joint venture operations
2	Manufacturing and research and development of automobile electronic devices	Automobile electronic bus network technologies	Limited to equity joint venture operations
		Electronic controllers for electric power steering systems	Limited to equity joint venture operations
3	Manufacturing of key parts and components of new energy automobiles	High energy power batteries (energy density $\geq$ 110 Wh/kg, cycle life $\geq$ 2000 times	The proportion of foreign investment not exceeding 50%
4	Manufacturing of track transportation equipment		Limited to Sino-foreign equity or contractual joint ventures
5	Design, manufacturing and maintenance of civil aircraft	Aircraft for trunk lines and regional aircraft	With Chinese party as the controlling shareholder
		Utility aircraft	Limited to Sino-foreign equity or contractual joint ventures
6	Design and manufacturing of civil helicopters: three tons or more		With Chinese party as the controlling shareholder
7	Manufacturing of ground-effect and water-effect aircraft and design and manufacturing of unmanned aircraft and aerostats		With Chinese party as the controlling shareholder
8	Manufacturing and repair of marine engineering equipment (including modules)		With Chinese party as the controlling shareholder
9	Manufacturing of low and medium-speed diesel engines of vessels and bent axle		With Chinese party as the controlling shareholder
10	Design and manufacturing of civil satellites, and manufacturing of civil satellite payloads		With Chinese party as the controlling shareholder
11	Construction and operation of nuclear power stations		With Chinese party as the controlling shareholder
12	Construction and operation of power grid		With Chinese party as the controlling shareholder
13	Construction and operation of network of trunk railway lines		With Chinese party as the controlling shareholder
14	Construction and operation of civil airports		With Chinese party as the relatively controlling shareholder
15	Air transportation companies		With Chinese party as the controlling shareholder, and the proportion of investment by the foreign

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No.	Catalogue of encouraged industries for foreign investment	Restricted measures
		investor and its affiliated enterprise shall not exceed 25% of the total amount of investment
16	General airline companies for agriculture, forestry, and fishery	limited to Sino-foreign equity or contractual joint ventures
17	Scheduled or non-scheduled international marine transportation services	limited to Sino-foreign equity or contractual joint ventures
18	Accounting and auditing	The managing partner shall have Chinese nationality
19	Construction and operation of comprehensive water control projects	With Chinese party as the controlling shareholder

No.	Catalogue of restricted industries for foreign investment	Restricted measures
1	Selection and cultivation of new varieties of crops and production of seeds	With Chinese party as the controlling shareholder
2	Exploration and exploitation of special and rare kinds of coal	With Chinese party as the controlling shareholder
6	Processing of edible oils and fats from soybean, rapeseed, peanut, cottonseed, camellia seed, sunflower seed, palm, etc.	With Chinese party as the controlling shareholder
7	Production of biological liquid fuels (fuel ethanol and biodiesel)	(With Chinese party as the controlling shareholder)
8	Printing of publications	With Chinese party as the controlling shareholder
10	Smelting and separation of rare earth elements	Limited to Chinese-foreign equity or contractual joint ventures
11	Manufacturing of complete automobiles, special purpose motor vehicles and motorcycles	The proportion of Chinese shares shall not be less than 50%. A foreign investor may set up at most two joint ventures to manufacture complete products of the same kind (including passenger vehicles, commercial vehicles and motorcycles), but such limitation can be ignored if the foreign investor, jointly with its Chinese equity partner, acquires other Chinese automobile manufacturers
12	Repair, design and manufacturing of ships (including subsections)	With the Chinese Party as the controlling shareholder

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No.	Catalogue of restricted industries for foreign investment		Restricted measures
15	Construction and operation of pipeline networks for gas, heat, and water supply and sewage in cities with a population of more than 500,000		With the Chinese Party as the controlling shareholder
16	Railway passenger transport companies		With Chinese party as the controlling shareholder
18	Water transport companies		With Chinese party as the controlling shareholder
19	General airlines for official duties, sightseeing, photography, prospecting, industries and other purposes		With Chinese party as the controlling shareholder
20	Telecommunication companies	Value-added telecommunication services (except for e-commerce)	With the proportion of foreign investment not exceeding 50%
		Basic telecommunication services	With the proportion of foreign investment not exceeding 49%
22	Vessel agencies		With Chinese party as the controlling shareholder
	Ocean shipping tally companies		Limited to Sino-foreign equity or contractual joint ventures
23	Wholesale of product oil and construction and operation of gas stations		In the case of the same foreign investors selling product oil of different varieties and brands from multiple suppliers through more than 30 chain gas stations, the Chinese parties shall be the controlling shareholders
24	Banks		The proportion of investment in capital in a Chinese-funded commercial bank by a foreign financial institution and the affiliated party under common control as promoter or strategic investor shall not exceed 20%, while the proportion of investment in capital in a Chinese-funded commercial bank by more than one foreign financial institutions and the affiliated party under common control as promoter or strategic investor shall not exceed 25%, and the foreign financial institutions investing in China's small or middle-sized financial

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No.	Catalogue of restricted industries for foreign investment		Restricted measures
			intuitions in rural areas must be banking financial institutions
25	Insurance companies	Life insurance	The proportion of foreign investment shall not exceed 50%
26	Securities companies		Limited in establishment to underwriting and sponsoring of A-shares, B-shares, government and corporate bonds, brokerage of B-shares, brokerage and proprietary trading of government and corporate bonds, qualified companies which have been established for two years or more may apply for expansion of business scope; and the proportion of foreign investment shall not exceed 49%
	Securities investment fund management companies		With the proportion of foreign investment not exceeding 49%
27	Futures companies		With Chinese party as the controlling shareholder
28	Market survey	Radio and television ratings surveys	The Chinese party as the controlling shareholder)
		Other market survey	Limited to Sino-foreign equity or contractual joint ventures
30	测Surveying and mapping companies		With Chinese party as the controlling shareholder
31	Higher learning institutions		Limited to Sino-foreign contractual joint ventures; the principal or main administrative responsible person shall be Chinese, the Chinese members of the Board or Co-management Committee of the Sino-foreign contractual joint venture shall not be lower than 1/2
32	Ordinary senior high schools		Limited to Sino-foreign contractual joint ventures; the principal or main administrative responsible person shall be Chinese, the Chinese members of the Board or Co-management Committee of the Sino-foreign contractual joint venture shall not be lower than 1/2
33	Pre-school educational institutions		

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No.	Catalogue of restricted industries for foreign investment	Restricted measures
		Limited to Sino-foreign contractual joint ventures; the principal or main administrative responsible person shall be Chinese, the Chinese members of the Board or Co-management Committee of the Sino-foreign contractual joint venture shall not be lower than 1/2
34	Medical institutions	Limited to Sino-foreign equity or contractual joint ventures
35	Production of radio and television programs and movies	Limited to contractual joint ventures
36	Construction and operation of movie theaters	With Chinese party as the controlling shareholder
38	Performance brokerage agencies	With Chinese party as the controlling shareholder

Despite the difference in the mandatory governance structure, *Company Law* shall apply to the foreign-invested LLCs in respect of the corporation governance where there is not any special provision in WFOE Law and EJV Law and CJV Law.

1.4 Representative Office of Foreign Enterprise

A. **Nature and Legislation**

The Representative Office of Foreign Enterprise ("**RO**") refers to the dependent representative institution established by foreign/oversea enterprise for the purpose of engaging in non-profit activities, mainly in a liaison capacity, and thus possesses no legal person status under PRC laws. The aforementioned foreign enterprise shall be the profit organization which has been established for at least 2 years outside the territory of the mainland of PRC in accordance with the governing laws under such territory. A company incorporated in Hong Kong, Macao and Tai Wan shall be referred to as the "oversea company" while incorporating a RO in the mainland of PRC.

There is no independent law to govern the RO, however, there are two general effective regulations: *Interim Provisions of the State Council of the People's Republic of China on Administration of Resident Representative Offices of Foreign Enterprises* promulgated on October 30, 1980 ("**Interim Provisions on RO**"), and *Administrative Regulations on the Registration of Resident Representative Offices of Foreign Enterprises* promulgated on July 18, 2013 ("**Regulations on RO**").

These are supplemented by several regulations and measures to govern the ROs in some special industries which will be listed in the following.

According to the Regulations on RO, a RO shall not engage in any profit-making activities, unless otherwise stipulated by the international treaties or agreements to which China is a party and has made no reservations of such clauses.

Generally, the activities a RO may engage in shall be non- profit and in connection with the business of the foreign enterprise including: *(i) market investigation, display, publicity activities in connection with the products or services of foreign enterprise; and (ii) liaison activities in connection with product sales, service provision, domestic procurement and domestic investment of foreign enterprise (Article 14 of Regulations on RO).*

B. **Establishment and Amendment**

The name of a RO shall strictly consist sequentially of the followings: nationality of its foreign enterprise, Chinese name of the foreign enterprise, name of resident city and the wording of "representative office".

To establish a RO in China, the foreign enterprise shall legally have been operated for at least two years. Furthermore, the foreign enterprise shall also provide their certificate of domicile, articles of association or organization agreement and the funds credit certificate issued by the financial institutions having business transactions with the foreign enterprise.

The resident period of a RO may not exceed the subsisting period of the foreign enterprise. The resident place of a RO shall be the foreign enterprise's autonomous choice. Nonetheless, according to the needs for national security and social and public benefits, the authorities may require the RO to adjust the resident place.

To run the RO established in China, the foreign enterprise shall appoint a chief representative and may appoint 1 to 3 representatives according to business needs. The chief representative may, within the written authorized scope of the foreign enterprise, sign the registration application documents for the RO on behalf of the foreign enterprise. However, the persons under the following circumstances shall not be the chief representative or the representative: *(i) who are sentenced due to being detrimental to the national security or social pubic benefits of the PRC; (ii) who are chief representatives or other representatives of the ROs that are legally revoked the establishment registration, or cancelled the registration certificate or ordered to close by relevant departments due to committing any breach activity that will be detrimental to national security or social public benefits of the PRC and there are less than five years as of the date of such revocation, cancellation or order; or (iii) other circumstances as provided by the State Administration for Industry and Commerce(Article 12 of Regulations on RO).* The chief representative and representatives shall apply for the resident permit and work permit on the strength of the Registration Certificate of the RO and their Representative Certificate.

Once established, the RO shall submit an annual report to the registration authority between March 1 and June 30 every year. Such an annual report shall

indicate the lawful subsisting situation of the foreign enterprise, the business activities of the RO and the information on the expenses and expenditure and revenues audited by the accounting firms and other related information.

Where there is any change to the registered matters of the RO, the foreign enterprise shall apply for alteration registration with the Registration Authorities within 60 days upon the date of change of the said matters. Additionally, where there is any change to the authorized signatory, the enterprise liability form, capital (assets), business scope and representatives of the foreign enterprise, the foreign enterprise shall also file the application for record with the Registration Authorities within 60 days upon the date of change of the said matters.

Furthermore, both the establishment and amendment of the RO shall be announced to the general public on the media designated by the Registration Authorities.

C. **Special Industry for Approval**

The authorities may require the foreign enterprise to get an approval before the registration procedure to establish a RO in some special industries. For example, where a foreign law firm is to establish a RO in China, it shall obtain the permission of the judicial administrative department under the State Council; where a foreign air transport enterprise is to establish a RO in China, it shall be approved by the General Administration of Civil Aviation of the People's Republic of China. There are same requirements for the insurance industry governed by China Insurance Regulatory Commission and foreign stock exchange industry governed by China Securities Regulatory Commission.

The following independent administrative regulations and measures shall be referred and executed to standardize the establishment and business of ROs in the above industries: *Administrative Regulations on the China-based Representative Offices of Foreign Law Firms* promulgated on December 22, 2001; *Administrative Measures for the Examination and Approval of Permanent Representative Offices of Foreign Air Transport Enterprises* promulgated on April 3, 2006; *Administrative Measures for the Representative Agencies of Foreign Insurance Institutions in China* promulgated on July 12, 2006; *Measures for the Administration of Representative Offices of Foreign Stock Exchange* promulgated on May 20, 2007.

D. **Other Issues**

a. Operation Funds

A RO shall, on the strength of the registration certificates and in accordance with the relevant stipulations of the State Administration for Foreign Exchange, open accounts at any bank designated by the State Administration for Foreign Exchange. Since there are no requirements relating to the "registered capital" of other investment types, the RO's operation funds should be directly allocated by the foreign enterprise to such accounts. The RO shall legally establish account books to record the information on such funds allocation, including its expenses, expenditure and revenue.

b. Employment

According to Interim Provisions on RO, the RO shall entrust local foreign affairs service organizations or other organizations designated by the Chinese Government as agent to engage staff members rather than recruit the employees directly by itself.

E. **Summary**

Compared with other foreign investment type, the RO may be regarded as an easy testing-tool, to try to enter and gather knowledge about the Chinese market, providing low costs and risks. In this way, the foreign investors may collect information and establish relationships with their clients. However, the RO is obviously limited by the non-profit activities requirements. In the long run, therefore, it is not a good choice for foreign investors who have identified a wish to run long-term business in China.

1.5 The 2015 *Draft Foreign Investment Law*

Although WFOE Law, EJV Law, CJV Law and their Implementation Rules undertake a significant role in developing the foreign investment in China, currently, those Foreign-invested Laws and their Implementations Rules cannot adapt to further open the market for the foreign investors, especially since it is obvious that there are conflict provisions in respect of the governance structure between *Company Law* and *EJV Law and CJV Law*.

On January 19, 2015, the Ministry of Commerce of the People's Republic of China made available a Draft Foreign Investment Law, for discussion and comments by the public. The term for the submission of comments expired in February 2015. It is likely that a revised draft will soon be submitted to the State Council of the People's Republic of China, which, after further modifications, will present it to the Standing Committee of the National People's Congress for promulgation.

If enacted with the same contents as the current *Draft*, the proposed *Foreign Investment Law* would make important changes in the legal framework governing foreign investments. The Draft is not intended to be a better iteration or revision of the Three FIE Laws, but rather the Draft is to standardize and collate the old regime under new and more powerful rules. The new Law should replace and unify the three Foreign Investment Laws currently in place (see Sect. 1.3). It is expected that the new Law will bring the regulations applying to EJVs, CJVs and WFOEs closer to the rules that apply to purely domestic companies, thus streamlining corporate governance.

In terms of the governance structure, the *Draft* attempts to unify the foreign-invested enterprises' with the domestic enterprises' through Article 157 [Changes of Organization Forms and Organizational Structures of Enterprises] as below: Foreign-invested enterprises existing in accordance with the law before the entry into force of the Law shall, within three years after the entry into force of the

Law and in accordance with the Company Law of the People's Republic of China (hereinafter referred to as the "Company Law"), the Partnership Enterprise Law of the People's Republic of China, the Law of the People's Republic of China on Sole Proprietorship Enterprises, and other laws and regulations, change their organization forms and organizational structures, but if the existing term of operation of enterprises will expire within three years after the entry into force of the Law and the enterprises intend to extend the term of operation, such changes shall be made within the existing term of operation of the enterprises.

Before the changes are completed in accordance with the provisions of the preceding paragraph, the provisions on the organization forms and organizational structures of enterprises specified in the Law on Sino-foreign Equity Joint Ventures, the Law on Wholly Foreign-owned Enterprises and the Law on Sino-foreign Cooperative Joint Ventures shall continue to apply.

1.6 The Features of the *Draft*

We now concern ourselves with the features of the new draft law. The general tone of the draft is set out in the first Article, which begins with the purpose of the law, that is to, 'expand, open up, promote and regulate foreign investment… and accelerate the sound development of socialist market economy.'

A. **Wide Notions of "Foreign Investment" and "Foreign Investor"**

Under the Draft, the Nature of Investors is set to a binary standard, they are either Chinese or Foreign. "Chinese investors" are natural persons who are Chinese nationals, Chinese government agencies and any domestic enterprise controlled by Chinese nationals or government agencies. "Foreign investors" are foreign citizens, foreign governments, international organizations and entities controlled by foreign citizens and entities.

The definition of "foreign investment" provided under Article 15 of the *Draft* lends itself to cover most forms of foreign investment currently found in China: on-shore investment through the incorporation of a new entity; the acquisition of shares in an already existing Chinese entity; the financing of a Chinese entity for over 1 year; the acquisition of permits for the exploration and exploitation of natural resources to be carried out in the Chinese territory; the acquisition of real estate in China; the acquisition of the control of, or stakes in, a Chinese entity by contractual or other means.

Further, Article 15 paragraph 2 of the *Draft* specifies that "*Overseas transactions that result in the transfer of the actual control over a domestic enterprise to a foreign investor shall be deemed as an investment in Mainland China by the foreign investor*".

On the other hand, the Draft purports to take on a 'substance over form' approach to defining Foreign Investment. This entails an important change in the

approach to the concept of "foreign investor" (Article 11), from an approach that takes into account the nationality and registered country of the investors, to an approach that also considers the nationality and registered country of the controlling entity. As a result, an investment made by a Chinese company being controlled by a foreign investor will be deemed as a foreign investor and the Law will apply to such case (Article 11 paragraph 2 of the *Draft*).

Furthermore, within this new definition, the Draft erases the distinction between EJV, CJV and WFOEs as separate iterations of business vehicles. Instead, the Draft introduces the concept of actual (De Facto) control. An effect of this could be that investments by Chinese-controlled companies through offshore structures, in industries restricted to foreign investment, could be legitimized. Previously, Chinese investors would take a 'round-trip' to invest in China through companies registered in foreign nations, in order to receive preferential treatment specifically allocated to non-Chinese entities. Under the new rules, therefore, should the definition stand, these will likely be considered Chinese companies for the purpose of the Foreign Investment Law.

B. **Concept of "*De Facto* Control"**

The concept of "control" goes hand in hand with the concept of "foreign investor" when described in Articles 18 and 19 of the Draft. "Control" of a company is expressed in the following situations:

- An individual or entity holds, directly or indirectly, at least 50% of the shares or of the voting rights in a company;
- An individual or entity holds, directly or indirectly, less than 50% of the shares or of the voting rights in a company, but:

  (a) Can appoint, directly or indirectly, at least half of the members of the board of directors (or another equivalent decision-making organ);
  (b) Can arrange for at least half of the members of the board of directors (or another equivalent decision-making organ) to be persons of its own choice;
  (c) Has sufficient voting rights to exert a relevant influence on the decisions of the board of shareholders, of the board of directors or of other decision-making organs;

- An individual or company exerts a decisive influence on the functioning, the finances, the personnel or the technology of a company through contracts, trusts, or other means.

As can be seen from the above-illustrated Article, control of a company can be exerted in a number of ways, both directly and indirectly and therefore is not limited to formal shareholding. The reform will no doubt bring PRC law closer to Western systems, all of which regulate *de facto* control of a company (albeit in very diverse ways).

C. **Principle of National Treatment**

Before 2016, WFOE, CJV and EJV Laws required that the Examination and Approval System shall apply to the incorporation and alteration of the foreign-invested enterprise. Regardless of the scale of the foreign investment or the industry which the foreign investment enters into, the Examination and Approval System is a pre-procedure to the foreign-invested enterprise registration. Under the Examination and Approval System, in the case of a foreign-invested enterprise incorporation, generally speaking, the investors shall file to the competent Chinese authority with the Investor Existing Certificate (such as the passport, Business License or Certificate of Incorporation) and Foreign-invested Enterprise Incorporation Application Letter and Feasibility Study Report and Articles of Association and Directors Appointment Letter(s) and Supervisor Appointment Letter(s) for their reviewing and approval, which not only occupies the Chinese governance's human resource but also delaying the incorporation of the foreign-invested enterprise compared to the incorporation of a domestic enterprise. The main focus of the Entry Clearance approval process is to consider the impact of foreign investment on matters of public interest, including national security, energy resources and technological innovation.

Currently, the latest amended *WFOE, CJV and EJV Law* in 2016 emphasizes that, as long as the foreign investment does not involve an industry as listed in the Special Administrative Measures Catalogue (the Negative List), the incorporation and alteration of the foreign-invested enterprises shall just undergo the Filing and Recordation System rather than the Examination and Approval System, as a result, it will greatly promote the carrying out of the foreign investment in China. Following *2016 Amendment to WFOE Law and CJV Law and EJV Law*, on 8th October 2016, the Ministry of Commerce of the People's Republic of China promulgated *Interim Administrative Measures for the Record-filing of the Incorporation and Alteration of Foreign-invested Enterprises*, accordingly, this Interim Administration Measures constitute the basis to regulate the incorporation and alteration of the foreign-invested enterprises. In terms of the Negative List, the Ministry of Commerce of the People's Republic of China, also promulgated that the Negative List shall consist of the Encouraged Industry involving the requirements on the shareholdings percentage and senior management personnel and Restricted Industry and Forbidden Industry in 2015 Catalogue.

Compared to *Interim Administrative Measures for the Record-filing of the Incorporation and Alteration of Foreign-invested Enterprises* which could not explicitly specify that the National Treatment shall apply to the foreign investment in China due to its nature as the Regulation rather than the Law, the Draft, once it enters force as a Law, will officially establish that the principle of National Treatment shall apply to the foreign investment in China as long as it is not involved within an industry listed on the Negative List. This means that Foreign Investment in industries outside of the Negative List will be treated the same as Chinese companies.

D. **"Entry Permit" and "Catalogue of Special Administrative Measures"**

As mentioned in the preceding paragraph, currently, the Catalogue of Special Administrative Measures is promulgated by the Ministry of Commerce of the People's Republic of China and it shall consist of the Encouraged Industry involving the requirements on the shareholdings percentage and senior management personnel alongside adherence to the Restricted and Forbidden Industry in 2015 Catalogue.

According to Article 23 of the *Draft*, the Catalogue of Special Administrative Measures shall be established and promulgated by the State Council of the People's Republic of China. Moreover, the competent authority of foreign investment under the State Council shall, in concert with the relevant departments, propose suggestions on formulating or adjusting the Catalogue of Special Administrative Measures in accordance with multilateral, bilateral, and regional treaties, conventions and agreements signed by the State as well as the relevant laws, administrative regulations and decisions of the State Council on foreign investment, and submit such suggestions to the State Council for deliberation. According to Article 24 of the Draft, the Catalogue of Special Administrative Measures is classified into the Catalogue of Prohibitions and the Catalogue of Restrictions, moreover, the Catalogue of Restrictions shall specify in detail the restrictive conditions for foreign investments. Due to the principle of the National Treatment, we can anticipate that 2015 Catalogue will be replaced by the Catalogue of Special Administrative Measures *under the Draft* after the *Draft* entering into force.

Once the foreign investment falls under the Catalogue of Special Administrative Measures, according to Article 27 of the *Draft*, the Entry P*ermit System* shall apply. In essence, the Entry Permit System is the same as the Examination and Approval System under WFOE, EJV and CJV Law. Furthermore, Article 30 of the *Draft* specifies the requirements on the documents to be filed for reviewing as below: (a) the application, which shall include the followings: (1) information of the foreign investor and the actual controller thereof; (2) basic information about the foreign investment, including the investment amount, investment sector, region of investment, investment method, and ratio and form of contribution; (3) statement on the compliance with special administrative measures; (4) impacts of the foreign investment on energy resources, technological innovation, employment, environmental protection, work safety, regional development, capital project management and development of the industry; (5) statement on whether the national security review and anti-monopoly review will be triggered; (6) the licence issued by the competent authority of industry if an application for ex-ante industrial licensing is required; (7) information of the foreign-invested enterprise in respect of organizational form and governance structure if the incorporation or change of such foreign-invested enterprise is involved; and (8) methods of notification and service. and (b) documents and supporting materials relating to the content of the application; and (c) representations and declarations of the foreign investor and the actual controller thereof, and the commitments to the authenticity and integrity of the application materials.

The competent authorities of foreign investment may require foreign investors to submit supplementary materials relating to the content as set out in the preceding paragraph.

E. Transparency Requirements for Foreign Investors

Chapter 5 of the *Draft Foreign Investment Law* (Articles 75–99) is dedicated to transparency requirements. Foreign investors are under an obligation to report periodically on their transactions and on their financial situation. Transparency requirements are essentially divided into three parts: (i) initial reporting obligations, which must be fulfilled before an investment begins; (ii) subsequent reporting obligations, to be fulfilled after an initial investment has been made; and (iii) periodical reporting obligations.

An obligation to disclose sensitive information may be imposed on FIEs: for example, information as to the person or entity ultimately controlling the company or as to the financial source of a certain investment might be requested. This might be difficult or undesirable for investors operating through complex structures.

The breach of such transparency obligations might even entail criminal liability; in the spirit of the reform, the disclosure requirements will be balanced by the removal of the *ex-ante* administrative checks on each and every investment.

F. National Security Review

Another system that would be implemented, to balance the general elimination of the *ex-ante* checks on foreign investments, is the "National Security Review" regulated by Chap. 4 of the *Draft Foreign Investment Law* (Articles 48–74). The National Security Review has received an expanded scope to include any Foreign Investment that actually damages or potentially damages Chinese national security irrespective of their participating industry sector or controlling party (Foreign or Otherwise). As a consequence, whilst the Review has key areas that will be targeted, the very vague nature of the test for review presents uncertainty to investors, thus we must hope that the Review standards that will be promulgated separately will address the clarity issues.

The National Security Review is carried out by an ad hoc joint commission, formed by the Ministry of Commerce and by the National Development and Reform Commission, together with the other authorities concerned in the specific case. The review may start on the authorities' initiative or upon application from interested parties; in particular, the procedure may be started by the foreign investor itself, before performing an investment, with the obvious goal of avoiding to undergo the review once the investment has already begun.

The review procedure consists of two phases. The first phase is the "general review"; where, following the general review, the foreign investment operation is deemed to potentially endanger national security, then it will undergo a "special review".

In deciding whether a certain investment may endanger national security, the evaluating commission will mainly consider the following factors: (i) impact on national defense and related infrastructures; (ii) impact on research and development capacity in relation to technologies connected to national security; (iii) impact on key state infrastructures and technologies or on its IT safety; (iv) impact on resources that are critical for the life of the country, such as food and energy; (v) involvement of foreign governments in the investment under review; (vi) impact on the stable functioning of national economy; (vii) impact on public interest and public order.

At the end of the evaluation, the commission may decide to approve the investment, to approve it with restrictions or conditions, or to prohibit it.

A new National Security Review may be carried out on an already examined investment in two cases: (i) it becomes known that during the first review that relevant information was concealed or falsified; (ii) the conditions or restrictions imposed by the evaluating commission after the first review were disregarded.

G. **Impact of the Proposed Reform on Variable Interest Entities**

The phenomenon of Variable Interest Entities (VIEs) originated around the year 2000, with the purpose of eluding the limits to foreign investment that PRC laws impose in certain sectors. As already examined, Chinese law prohibits or strongly limits the acquisition by foreign individuals or entities of shares in companies operating in sectors that are strategic for the national economy and national security. However, these limitations are not sufficient to eliminate Chinese companies' interest in raising capital overseas and thus the VIE structure was born.

The most common VIE structure involves incorporating a non-PRC company, the shares of which are listed on foreign stock exchanges; such a non-PRC company will be managed by the same individuals that control the PRC company being the real beneficiary of foreign investment (the "variable interest entity"). The foreign company remits the raised capital to the PRC company through, e.g., the payment of royalties. The only link between the VIE—the only one to hold the assets and licenses necessary to carry out the activity limited to foreign investors—and the company collecting foreign investment consists of its directors.

The main problem with such a structure is that the foreign investors do not actually hold any portion of the capital of the VIE which exposes them to risks and possible abuses. The possible types of risk are that: (i) the individuals managing the VIE disobey or "flee", leaving the investors of the corresponding foreign company without any legal remedy; (ii) PRC authorities take measures that jeopardize or damage the interests of the VIE, once again, without any legal remedy for the investors of the corresponding foreign company.

Therefore, VIEs are a rather controversial corporate structure; nonetheless, they are a quite common organizational choice, especially in the sectors such as information technology and online commerce.

Up till now PRC law has not taken a definitive stance on these structures. The question has arisen and continues to be debated, whether the VIE will be permitted to survive. The Foreign Investment Law, as currently available in the *Draft,* would have severe consequences in this area. On the one hand, the "negative list" would probably include the sectors involved by the VIE phenomenon in those subject to prohibition or restrictions on foreign investment; on the other hand, the wider concept of "foreign investment" contained in Article 15 of the *Draft* and the wider notion of "control" contained in its Article 18 lend themselves to encompass the VIEs.

The effect of the entry into force of the current *Draft Foreign Investment Law* concerns the future prospects of already existing VIE structures rather than the regulation of future similar structures. Article 158 of the *Draft*, dedicated to this very issue, is significantly left blank and contains a reference to the explanatory notes that accompany the *Draft*. Point 3.2 of the explanatory notes leads the reader to believe that the competent administrative authorities will decide, case by case if VIE structures will be permitted to survive, as they will need to obtain the relevant authorization as foreign entities. However, it is quite uncertain what methods and standards will be adopted by the competent administrations when granting such authorization.

H. **Dispute Resolution**

Currently, disputes regarding foreign investments are submitted to the People's Courts or solved through arbitration. Chapter 8 of the *Draft Foreign Investment Law* (Articles 119–125) establishes a particular mechanism for the handling of disputes arising between foreign investors or foreign-invested enterprises, on one side, and Chinese administrative authorities, on the other side, in relation to an investment. The *Draft* does not specify whether the new dispute resolution system will be mandatory; however, disputes not involving any Chinese administrative authority will continue to be settled in court or through arbitration.

1.7 The Competent Authorities on Corporate Governance

In this section, we will briefly present the main public organs and entities responsible for enacting rules on corporate governance. It is necessary to understand the legislative process in the context of other regulatory bodies in order to view the Company Law in its wider setting.

A. **National People's Congress and its Standing Committee**

The National People's Congress is the National Legislative Assembly of the People's Republic of China. In the Chinese Constitutional system, it is the organ from which all State power stems (Article 57 of the PRC Constitution). Under Chinese legal theory, interpreting the law is considered in itself a legislative

activity; therefore, interpretation of the law is carried out firstly by the National People's Congress itself (so-called *authentic interpretation*: Article 67, item 4 of the PRC Constitution).

The current Assembly is composed of about 3000 members and is not continuously in session; the Standing Committee of the National People's Congress, instead, is permanently in session. The Standing Committee is composed of 161 members.

The lawmaking process starts with the drafting of a bill, usually carried out by the competent Ministry or organ under the PRC State Council. Normally, the organs involved in the drafting process publish a draft for comments and collect observations from the public. When a legislative project is particularly important or contains many controversial points, a number of drafts may be published before achieving a definitive draft.

B. **China Securities Regulatory Commission**

The *China Securities Regulatory Commission* (CSRC) is the organ under the State Council—the Chinese central executive organ—in charge of supervising and regulating the Chinese securities market. Over time, the amendments to the Securities Law have strengthened the power of the Commission, enriched its functions, its structure and its personnel.

The main functions of the CSRC are to promote the transparency and the healthy development of the Chinese securities market, in an effort to improve investor trust and the economic growth of the country. While performing these functions the Commission also works in cooperation with its foreign counterparts.

The CSRC's supervisory function is exercised through administrative channels. The Commission will impose sanctions on entities that violate the relevant laws and regulations.

The specific tasks of the CSRC include:

- elaborating draft laws, policy guidelines and regulations regarding the issuance and the exchange of negotiable securities;
- supervising the issuance and the exchange of shares, bonds and securities;
- supervising every other public authority in charge of administrating the securities market, as well as securities companies;
- examining of qualifications and personnel of all companies, entities and institutions operating in the field of negotiable securities;
- collecting and publishing statistics and information on the Chinese securities market;
- investigating and punishing violations of securities laws and regulations;
- any other tasks entrusted to the CSRC by the State Council.

C. **State Administration of Industry and Commerce**

The State Administration of Industry and Commerce (SAIC) is the ministry-level organ in charge of supervising and regulating the market in general; in the exercise of such function, it issues detailed rules for the implementation of the legislation

regarding industry and commerce. The State Administration of Industry and Commerce is situated at the top of a capillary network of local offices.

Among SAIC's tasks, the following are the most prominent:

- to elaborate regulations and directive guidelines for the administration of industry and commerce;
- to handle the registration of all types of companies and enterprises;
- to supervise fair competition and to control that market transactions are carried out respecting all applicable rules;
- to protect consumers and handle their claims;
- to protect trademarks;
- to investigate and handle irregular business operations;
- to regulate sale and brokering activities;
- to supervise all forms of advertising activity and to guide the development of the advertisement industry;
- to cooperate with its foreign counterparts in order to carry out the mentioned functions.

D. The State Administration of Foreign Exchange

The State Administration of Foreign Exchange (SAFE) is in charge of the exchange between Renminbi and foreign currencies and of foreign currency reserves; it handles transactions involving foreign exchange; it adopts policies aimed at increasing the convertibility of Chinese currency.

The huge currency reserves held by the Chinese government and the role of the Renminbi in the global economy have made the role of SAFE in financial and currency markets more and more important. SAFE was a hierarchically independent entity until 1998, when the central government decided to subordinate it to the People's Bank of China.

The SAFE's main tasks are the following:

- to control and handle the exchange market;
- to propose reforms of the exchange handling system;
- to elaborate rules and law proposals regarding the exchange administration;
- to investigate and sanction the breach of rules and regulations on foreign exchange;
- to adopt measures to computerize procedures and data related to foreign exchange;
- to provide foreign credit and debt statistics, as well as cross-border capital fluxes;
- to cooperate with its foreign counterparts in order to carry out the mentioned functions.

E. **National Development and Reform Commission**

The National Development and Reform Commission (NDRC) has wide administrative, control and planning powers on the Chinese economy through which it guides the restructuring of the Chinese economic system.

Its main tasks include:

- carrying out research and analysis on national and international economic development;
- formulating recommendations with regards to a number of economic instruments and policies;
- formulating goals for the development of economy-related legislation;
- maintaining balance and control over the resources which are most important for the country;
- elaborating laws and regulations regarding the economic and social development of the country, including the restructuring of the economic system and gradual opening to the outside world.

F. **Ministry of Commerce**

The Ministry of Commerce (MOFCOM) elaborates foreign trade policies regarding; issues regulations concerning import, export, direct foreign investment, consumer protection, market competition; negotiates bilateral and multilateral foreign trade agreements.

The Ministry has a number of Departments, the main ones being: the Department of Foreign Economic Cooperation; the Department of Fair Trade in Imports and Exports; the Department of Market Economic Order; the Department of Trade Reform. Moreover, there are a Disciplinary Department and an Investigation Department.

Together with the NDRC (see preceding paragraph), the Ministry of Commerce has a leading role in the development of Chinese legislation. These two organs usually express a progressive and innovative approach. However, the effect of this driving force is balanced by the resistance of a number of other more conservative administrations, among which the SAIC and the SAFE, which directly control the most practical aspects of trade and are often reluctant to concede powers. Therefore, the laws that are passed by the National People's Congress are usually less progressive in approach than the corresponding initial drafts set out by MOFCOM and NDRC; this may also be the case also for the currently pending *Draft Foreign Investment Law* (see Sect. 1.4).

G. **State-owned Assets Supervision and Administration Commission**

The State-owned Assets Supervision and Administration Commission (SASAC) was established in 2003 through the merger of a number of pre-existing administrative organs. The Commission, among other functions, is in charge of administrating State-Owned Enterprises (SOEs). In this function, it appoints and dismisses

directors and the senior management; it decides on the authorizations necessary for mergers and for the sale of assets or shares, bonds, etc. of SOEs; it drafts legislation pertaining to SOEs.

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Chapter 2
Companies Under Chinese Law

The structure *of Company Law* (*revised in 2005*), which was maintained in current Company Law (revised in 2013), represented an important text in the modernization process of Chinese company law. However, despite the innovation and the strive to adapt to international standards; several normative gaps are present, and this is especially evident where corporate governance is concerned.

The Company Law regulates two types of companies: Limited Liability Companies (LLC) and Joint Stock Companies (JSC); their incorporation, the functioning of their organs (board of shareholders, board of directors, board of supervisors) and to their operation[1] are regulated therein. Therefore, the word "company" refers to an entity established in the People's Republic of China, as one of the aforementioned forms, and subject to the discipline of the Company Law.[2]

The first twenty-two articles of the Company Law, composing Chapter One (*General Provisions*), apply both to LLCs and to JSCs. In this Chapter, some features of "socialism with Chinese characteristics" are quite evident.[3] The articles in Chapter Two and Three apply to LLCs while the articles in Chapter Four and Five apply to JSCs. From Chapter Six to Thirteen (excluding Chapter Eleven) also apply to both kinds of companies. Chapter Eleven is concerned with branches of foreign companies.

[1]Article 8 of Company *Law*: "*The name of a limited liability company established in accordance with the Law shall feature the words* "*limited liability company*" *or* "*company limited*".

The name of a company limited by shares established in accordance with the Law shall feature the words "*company limited by shares*" *or* "*joint stock company*"".

[2]See Article 2 of *Company Law*.

[3]For example, Article 1 of *Company Law* lists, among the aims of corporate legislation, that of "*promoting the development of socialist market economy*"; under Article 17 paragraph 2, a company should use various methods to strengthen the education and the formation of its employees on the job, so as to improve their capabilities; finally, Article 19 states that companies should facilitate the activities of the Chinese Communist Party established within the company in accordance with the Constitution of the Party.

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G. Pisacane, *Corporate Governance in China*, China Law,
Tax & Accounting, DOI 10.1007/978-981-10-3911-9_2

As a brief introduction, the term "foreign company" refers to "*a company established outside the territory of China under any foreign law* (*Article 191 CL*)". According to Article 192 CL, '*to establish a branch in China*, *a foreign company shall file an application with China*'*s competent authority and submit relevant documents such as its articles of association*, *the company registration certificate issued by its country*, etc. *Upon approval*, *it shall go through registration procedures with the company registration authority according to the law and obtain a business license. The branch shall comply with the law of China and may not harm China*'*s social public interests*, *and correspondingly*, *the lawful rights and interests of such branch shall be protected by the laws of China. And please note that the branch established by a foreign company within the territory of China shall not have the status of a legal person*, *which means the foreign company who establishes the branch shall bear civil liability for business operations of the branch carried on within the territory of China.*'

Under Chapter Two of LLCs, there are some special provisions on single shareholder limited liability companies and wholly state-owned companies. To prevent an individual abusing the limited liability structure, Article 57 CL defines the term, "single shareholder limited liability company" as "*a limited liability company with only one natural or legal person as a shareholder*". The Law restricts a natural person to establish only one single shareholder limited liability company and in turn, such a company shall not establish any new single shareholder limited liability company. Article 63 CL pronounces that, if the shareholder of a single shareholder limited liability company is unable to prove that the property of the company is independent of the shareholder's own property, the shareholder shall bear joint and several liability for the debts of the company.

Generally, LLCs are the most common company type in China and are preferred by foreign investors. For the benefit of the reader, this review will focus on the general LLCs and its structure and governance.

Chapter 3
Incorporation and Articles of Association

3.1 Overview

The company's articles of association have a central role in Chinese Company Law. The first PRC Company Law, enacted in 1993, listed in its Article 22 a number of limited topics to be regulated in the articles of association, without allowing companies any choice as to the inclusion of supplementary provisions. Therefore, the articles of association of Chinese companies ended up all being quite similar, without any flexibility to adapt the articles of association of each company's size, nature and business scope: they were, in a way, a pre-defined document, that each company needed to 'fill in,' and the consequences of this are obvious.

Many provisions of the Company Law 2005 amendment, allowed the shareholders to tailor the articles of association to the company's specific needs and function's. The current version of the Law abandons the previous rigidity and favors a more flexible approach. Therefore, the parties' freedom is the principle governing the matter, to a large extent, and therefore investors are, to a certain degree, free to insert more appropriate provisions, able to satisfy the needs of each single company, in the articles of association. Most rules concerning the company structure and functioning may therefore be modified or further detailed by the shareholders through the company's articles of association.

In addition to the foregoing, the shareholders are encouraged to include the provisions related to the financial management of the company in the articles of association. For example, the shareholders have the right to decide in the articles of association the proportion in which profits will be distributed and such proportion may be different from the proportion of shareholding. This guarantees remarkable flexibility in the financing of LLCs.

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G. Pisacane, *Corporate Governance in China*, China Law,
Tax & Accounting, DOI 10.1007/978-981-10-3911-9_3

3.2 Company Incorporation

In order to proceed with incorporation of an LLC, some preliminary conditions, found at Article 23 of the Company Law, must be satisfied, these include:

- the number of shareholders must correspond to that set forth by the law[1];
- the capital contributions subscribed by the shareholders must correspond to the provisions contained in the articles of association;
- the shareholders must have jointly elaborated the articles of association;
- the company must have a name and an organizational structure fulfilling the legal requirements;
- the company has its own administrative headquarters.

Particularly, unless otherwise provided in any other laws, administrative regulations and decisions of the State Council, in terms of the registered capital, thanks to *2013 Amendment to Company Law*, the shareholders of the LLCs have been granted the freedom to decide the amount of registered capital and capital contribution manner and term as below:

A. **Amount of Registered Capital**

The *2013 Amendment to Company Law* has abolished the pre-existing thresholds of RMB 30,000 for LLCs and RMB 100,000 for one-person LLCs. Under Article 26 of *Company Law*, it has stated that the LLC's capital corresponds to the total capital subscribed by the entire shareholder upon incorporation of a company as registered with the Company Registration Authority.

Additionally, in general, the foreign-invested LLCs now do not need to meet a minimum capital requirement,[2] more precisely the minimum capital that needs to be subscribed by the shareholders upon incorporation of a company is not predetermined by laws or regulations. Comparatively, under old Examination and Approval System, although Company Law granting the shareholders to freely decide their registered capital of the LLCs as long as the LLCs not subject to any specially registered capital requirement provided by other laws or administrative regulations or decisions of the State Council, in practice, the authority could question the feasibility of a low registered capital of a foreign-invested LLC. In other words, the foreign-invested project is evaluated by the Chinese authorities, which will quantify the minimum capital that the investors must subscribe according to the actual amount of finances necessary in practice to achieve the company's business purpose[3]; Under the current Filing and Recordation System, as long as not

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[1]Article 23 CL sets this number at no more than fifty shareholders for limited liability companies.

[2]Since 2005, *Company Law* has abolished the difference between the minimum capital for totally foreign-owned JSCs and domestic JSCs. However, the minimum capital of foreign-invested JSCs was increased for some sectors—e.g., the banking, insurance and finance sector.

[3]Investors submit to the authority a feasibility study in which they indicate the financial resources needed in order to make the relevant business correctly operational. Given this circumstance, the

involving any specially registered capital requirement provided by other laws or administrative regulations or decisions of the State Council, the foreign investors can be truly free to decide the registered capital of their foreign-invested LLCs in China based on their business plan.

B. **Capital Contribution Manner**

Under *Company Law* (*revised in 2005*), it allows the shareholders to make a capital contribution by non-monetary property, at the same time, it requires that the value of capital contribution by non-monetary property cannot exceed 70% of the total registered capital. Currently, thanks to *2013 Amendment to Company Law*, shareholders can make capital contribution entirely by non-monetary property (except for those assets that shall not be used as capital contributions under any other law or administrative regulation) as long as the value of which can be assessed in currency and the ownership of which can be transferred in accordance with the law.

Coherently, the foreign-invested LLCs can follow the new rule as above in *2013 Amendment to Company Law.*

C. **Capital Contribution Term**

Under *Company Law* (*revised in 2015*), it is required that the shareholders contribute at least 20% of the registered capital within 90 days as of the issuance of the LLCs' business license and to contribute the remaining capital within 2 years as of the issuance of the LLCs' business license. Currently, thanks to *2013 Amendment to Company Law*, the capital contribution term shall be freely decided by the shareholders in the Articles of Association.

Under Article 28 of *Company Law*, each shareholder must contribute his subscribed capital in full and within the term established in the articles of association: in this sense *2013 Amendment to Company Law* restored the rules on contributions in force before 2005.[4] If a contribution is made in currency, it must be paid to a bank account opened in the LLC's name; if a contribution is made in kind, the procedures set forth by law must be observed.[5] Moreover, Article 28, paragraph 2 of *Company Law* states that "*If a shareholder fails to make capital contribution in accordance with the preceding paragraph*, *it shall*, *in addition to making capital*

(Footnote 3 continued)

general framework regarding capitalization acquires a somewhat "theoretical" nuance, given that local authorities discretionally approve investment project (usually Shanghai authorities tend to require a minimum registered capital of USD 150,000–200,000).

[4]As a matter of fact, Article 26 of *Company Law* (*revised in 2005*) provided that the amount of initial contributions paid by the shareholders (within 90 days) could not be lower than 20% of the registered capital or of the minimum capital applicable to the company at issue; the remainder was to be paid within two years of incorporation of the company.

[5]After it has been incorporated, a company issues to each shareholder a certificate proving that the relevant contributions have actually been made. In particular, under Article 31 of the Company Law, said certificate must contain the following indications: (i) name of the company; (ii) date of incorporation; (iii) registered capital of the company; (iv) name of the shareholder, amount of the contribution and date of the contribution; (v) serial number and issuance date of the certificate.

contribution in full to the company, be liable for breach of contract to the shareholders that have made their capital contributions on time and in full".

Coherently, the foreign-invested LLCs can follow the new rule as above in *2013 Amendment to Company Law.*

As a summary, after carrying out all the necessary incorporation procedures, a company may be registered. A representative or an agent of the company is responsible for the company registration with the Administration for Industry and Commerce (see § 1.5, C).[6] The authority releases a business license, which certifies the correct incorporation of the company. According to the reform of combining the business license, organizational code certificate and tax registration certificate into one, the business licenses shall be marked with the unified credit code to newly-established enterprises or enterprises subject to any change as of October 1, 2015. Therefore, the company does not need to be registered with tax and quality supervision authorities. The company will later have to be registered with the relevant labor and foreign exchange authorities.

3.3 Articles of Association

As one of the requirements to incorporate an LLC, the Articles of Association shall be delicately prepared by the shareholders for theirs' and the company's interest. Given the significance of the Articles of Association, we need to learn some fundamental clauses in *Company Law*.

Under Article 11 of *Company Law*, "A company shall formulate its Articles of Association in accordance with the law. The articles of association shall be binding on the company and its shareholders, directors, supervisors and senior officers."

Under Article 13 of *Company Law*, "the legal representative of a company shall be the chairman of its board of directors, its executive director or its manager in accordance with the articles of association of the company, and shall be registered as such in accordance with the law. In the event of a change of the legal representative of the company, the company shall go through the formalities for registration of the change."

Under paragraph 1 of Article 16 of *Company Law*, "Where a company intends to invest in any other enterprise or provide a guaranty for any other person, a resolution shall be passed, pursuant to the company's articles of association, by the company's board of directors, the board of shareholders or general meeting. Where the articles of association prescribe any limit on the total amount of investments or

[6]Article 29 CL 2013 reads as follows: "*After the shareholders have subscribed capital contributions in full as set forth in the articles of association, the representative designated by all shareholders or the agent jointly appointed by them shall submit a company registration application and documents such as the articles of association of the company to the company registration authority to apply for registration of establishment*".

guarantees allowed, or on the amount of a single investment or guaranty allowed, the said total amount or amount shall not exceed the limits prescribed."

Under paragraph 2 of Article 22 of *Company Law*, "Where the procedures for calling a meeting of the board of shareholders or general meeting, or a meeting of the board of directors, or the voting method used therein violates any law, administrative regulation or the company's articles of association, or where any resolution violates the company's articles of association, the shareholders may, within 60 days as of the date on which the resolution is passed, petition a people's court to nullify it."

Under paragraph 1 of Article 147 of *Company Law*, "The directors, supervisors and senior officers of a company shall comply with laws, administrative regulations, and the articles of association and shall owe duties of fidelity and due diligence to the company."

Under Article 149 of *Company Law*, "Where any director, supervisor or senior officer violates any law, administrative regulation, or the articles of association in the course of performing his duties, he shall be liable to compensate the company for any loss thereby caused to the company."

Specifically, regarding the LLCs' Article of Association, we have the provisions as below:

Firstly, there is a general clause under Article 25 of *Company Law*, "*The articles of association of a limited liability company shall specify the following details*:

i. *Name and domicile of the company*;
ii. *Business scope of the company*;
iii. *Registered capital of the company*;
iv. *Name and domicile of the shareholders*;
v. *Method*, *amount and time of capital contribution by the shareholders*;
vi. *Organization of the company and its methods of establishment*, *functions and powers*, *and rules of procedure*;
vii. *Legal representative of the company*; *and*
viii. *Other matters that the shareholders should deem it necessary to specify.*

Shareholders shall sign and affix their seals on the articles of association of the company".

In terms of the LLCs' Board of Shareholders, apart from its legal power and function bestowed by *Company Law*, under Article 37 of *Company Law*, the Board of Shareholder is entitled to exercise the power and function set forth in the Articles of Association.

Under Article 41 of *Company Law*, "a notice of the meeting of the Board of Shareholders shall be given to shareholders 15 days in advance of the meeting Unless otherwise specified in the articles of association or otherwise agreed by all shareholders."

Under Article 43 of *Company Law*, "Unless otherwise provided in the Law, methods of deliberation and voting procedures of the Board of Shareholders shall be specified by a company's Articles of Association."

In terms of the LLCs' Board of Directors, apart from its legal power and function bestowed by *Company Law*, under Article 46 of *Company Law*, the Board of Directors is entitled to exercise the power and function set forth in the Articles of Association. As to the Executive Director, under paragraph 2 of *Company Law*, "The functions and powers of the Executive Director shall be specified by the Articles of Association."

Under paragraph 1 of Article 48 of *Company Law*, "Unless otherwise provided in the Law, methods of deliberation and voting procedures of the board of directors shall be specified by the company's Articles of Association."

In terms of the LLCs' manager, under Article 49 of *Company Law*, the power and function as set forth in Articles of Association can prevail over the manager's legal power and function as set forth in *Company Law*.

In terms of the LLCs' Board of Supervisor, under paragraph 2 of Article 51 of *Company Law*, "The board of supervisors shall include shareholders' representatives and an appropriate proportion of employee representatives which shall not be less than one-third of the members of the board of supervisors, the specific proportion of which shall be prescribed by the articles of association."

Apart from the Board of Supervisor or Supervisor's legal power and function bestowed by *Company Law*, under Article 53 of *Company Law*, the Board of Supervisors or the Supervisor is entitled to exercise the power and function set forth in the Articles of Association.

Under paragraph 2 of Article 55 of *Company Law*, "Unless otherwise specified in the Law, the methods of deliberation and voting procedures of the board of supervisors shall be specified by the articles of association."

3.4 Summary

As a summary, we can see that the Articles of Association conduct an irreplaceable role in regulating corporation governance due to the fact that the Articles of Association require all of the shareholders to approve them and thus this instigates a common understanding between themselves. Furthermore, Company Law bestows the Articles of Association with a great autonomy, enabling shareholders to establish a corporate governance structure that suits their functions, plans and powers.

Chapter 4
Shareholders and Board of Shareholders

4.1 Overview

The LLCs are established by the shareholders who fulfill their capital contributions to constitute the initial asset of the LLCs. On one hand, the Shareholders are treated as the owners of the LLCs based on which they can enjoy the profit and fundamentally control the management and business operation, on the other hand, the LLCs are defined as a legal person which are entitled to the ownership of the shareholders' capital contribution and other property generated during their business development. Basically, the shareholders need to build a diligent and efficient governance structure in order to make the LLCs achieve the sustainability and become a profitable business, in the meantime, the shareholders and Board of shareholders (a mandatory organ in the LLCs' governance structure except for one —person LLCs and EJV LLCs and CJV LLCs) should be governed as well for the benefit of the LLCs.

4.2 Shareholders' Rights and Obligations

The LLCs' Board of Shareholders, in its entirety, consists of all of the shareholders. To understand the role of the board in corporate governance we must first understand the nature and extent of both the shareholder's rights and obligations. Firstly, we need to learn the basic legal rights and obligations as set forth in *Company law* for the shareholders. On the one hand, *Company Law* provides the shareholders with the fundamental right and specific rights, on the other hand, *Company Law* imposes the fundamental obligation and specific obligations on the shareholders.

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G. Pisacane, *Corporate Governance in China*, China Law, Tax & Accounting, DOI 10.1007/978-981-10-3911-9_4

A. Fundamental and Specific Rights

In terms of the fundamental right, as the initial provisions of *Company Law* contain some general provisions, stating that the Shareholders are entitled to enjoy a number of rights as owners of the company. Such rights regard the benefits arising from company profit, participation in the most important management decisions and the choice of management personnel.[1]

In terms of the specific rights of the LLCs' shareholders, *Company Law* grants the shareholder, regardless of their equity percentage, with the right to consult and copy the articles of association, minutes of meetings of the board of shareholders, resolutions of meetings of the board of directors, resolutions of meetings of the board of supervisors and financial reports. Furthermore, *Company Law* grants the shareholder with the right to consult the accounting books of the company via a written application stating the purpose. By means of exercising the aforementioned consulting and copying right, it will enable the shareholders to learn and supervise the real situation of the company's management for the purpose of regulating the corporation governance.

Apart from the consulting and copying right, *Company Law* guarantees that the shareholder of the LLCs can obtain dividends and receive new increases in capital in proportion to their paid-in capital.

Furthermore, under Article 151 and 152 of *Company Law*, where the directors or supervisors or senior management personnel in violation of the laws or administrative administrations or Articles of Association during their performance of duties and which causes the company to suffer loss or harms the interest of the shareholders, any shareholder in the LLCs can file the derivative lawsuit in his own name for the company or himself.

B. Fundamental and Specific Obligation

The enjoyment of such rights is, of course, subject to the respect of the relevant laws and regulations, in order to simultaneously preserve the interests of the company's creditors and shareholders.

Under Article 20 of *Company Law*, "*The shareholders of a company shall abide by laws, administrative regulations and the articles of association of the company and exercise shareholders' rights in accordance with the law, and shall neither harm the interests of the company or of other shareholders by abusing shareholders' rights nor harm the interests of any creditor of the company by abusing the company's independent status as a legal person or the limited liability of shareholders.*

Any shareholder of a company who causes any loss to the company or to other shareholders by abusing shareholders' rights shall be liable for compensation according to the law.

Where a shareholder of a company evades the payment of debts by abusing the company's independent status as a legal person or the limited liability of

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[1]See Article 4 of *Company Law*.

shareholders, thereby seriously harming the interests of the creditors of the company, it shall bear joint and several liability for the debts of the company".

Furthermore, under Article 21 of *Company Law*, the controlling shareholder shall not damage the interests of the company by taking advantage of his/its affiliated relation.

In terms of the specific obligation of the LLCs' shareholders, it mainly refers to the capital contribution obligation, failure to fulfill which can result in the responsibilities to the other observant shareholder and company and its creditor, particularly, in some cases the shareholders regardless the fulfillment of their capital contribution shall take the joint—liability to the company and its creditor.

Specifically, under Article 28 of *Company Law*, "Each shareholder shall, within the prescribed time limit, fully pay the capital contribution it subscribes for as stipulated in the articles of association. A shareholder making capital contribution in cash shall deposit the capital contribution in full in a bank account opened by the limited liability company. A shareholder making capital contribution with non-monetary assets shall complete the transfer procedures for the relevant property rights in accordance with the law.

Where any shareholder fails to make a capital contribution in the manner as specified in the preceding paragraph, the relevant shareholder shall not only make full payment to the company but shall also be liable for breach of contract to shareholders who have paid their capital contributions in full on time."

In terms of the joint-liability, under Article 30 of *Company Law*, "if the value of the non-currency assets contributed by a shareholder upon the company's incorporation is remarkably lower than the value fixed in the articles of association, such a shareholder will be under an obligation to make up for the difference and the other shareholders will bear joint and several liabilities for such difference." According to *Provisions of the Supreme People's Court on Several Issues Concerning the Application of Company Law of the People's Republic of China (III) (Revised in 2014)*, in the event a shareholder has not fulfilled or fully fulfilled its obligation of capital contribution when the company is being established, the company's creditor can claim that the aforementioned shareholder and the founders of the company should bear joint and several liabilities, the people's court shall sustain.

Furthermore, under Article 35 of *Company Law*, the shareholders shall not withdraw its capital contribution following the incorporation of the company."[2]

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[2]Under Article 12 of *Provisions of the Supreme People's Court on Several Issues Concerning the Application of Company Law of the People's Republic of China (III) (Revised in 2014)*, "Where, after the company is established, the company, any shareholder or any creditor of the company claims that a relevant shareholder has withdrawn capital contributed on the ground that acts of the shareholder conform to any of the following circumstances and injure the interests of the company, the people's court shall sustain:

1. prepares false financial statements to increase non-existing profits and distribute the same;
2. remits out the capital it contributed by making up false credit-debt relations;
3. remits out the capital it contributed through related-party transactions; or
4. any other acts that withdraws the capital without legal procedures."

4.3 Equity Transfer

The share capital of an LLC may be freely transferred between the shareholders (paragraph 1 of Article 71 of *Company Law*). On the other hand, when a shareholder wishes to transfer his shares to a third party outside the company, he will need the consent of more than half of the remaining shareholders and will have to notify them in writing in advance. In this case, where a shareholder does not respond within 30 days of receiving the relevant notice from the shareholder wishing to make the transfer, the former will be deemed to have given his consent.

Paragraph 3 of Article 71 of *Company Law* grants to every shareholder a right of first refusal when another shareholder wishes to transfer his shares: "*Provided conditions are equal, the other shareholders shall have the right of first refusal for the purchase of the equity interests the transfer of which has been consented by the shareholders. Where two or more shareholders exercise the right of first refusal, they shall determine their respective purchase ratio by negotiation, failing which they shall exercise the right of first refusal in proportion to their respective capital contributions at the time of the transfer*".

However, the shareholders may deviate from the default rules regarding equity transfer set forth in the Company Law by providing for different ones in the articles of association (paragraph 4 of Article 71 of *Company Law*).

Moreover, Article 74 of *Company Law* grants to the shareholder of an LLC a right to transfer his shares to the company (share repurchase):

"*Under any of the following circumstances, any shareholder who votes against the relevant resolution of the board of shareholders may require the company to purchase his/its stock rights at a reasonable price*:

1. *where the company has not distributed any profits to the shareholders for five consecutive years but has made profits during such period and conforms to the profit distribution requirements of the Law;*
2. *in the event of any combination, division, or transfer of the principal assets of the company; or*
3. *where the business term specified in the articles of association expires or any of the other grounds for dissolution prescribed in the articles of association is satisfied, and the meeting of the board of shareholders makes the company continue to exist by modifying the articles of association through adopting a resolution. Where the relevant shareholder and the company fail, within 60 days of the date on which the relevant resolution is adopted at the meeting of the board of shareholders, to reach an agreement on the purchase of stock rights, the shareholder may initiate a legal action in the people's court within 90 days of the date on which the resolution is adopted at the meeting of the board of shareholders.*"

The share repurchase system of the shareholders in China was established in 2005, granting companies the ability to repurchase shares from shareholders. As a result of the general trend of LLCs possessing a low count of shareholders, the

abuse of rights of the controlling shareholders are common. Born out of this is an unequal position of power when it comes significant matters of the company, such as a merger, division, the modification of the articles of association, dissolution. From this inequality, the controlling shareholders possess the power of decision due to the bigger proportion of voting rights. However, the shareholders who vote against the resolution of the board of shareholders are mostly the small and medium shareholders who are disadvantaged and have no choice nor effect on the decision. Consequently, such a repurchase system can protect the interests of these small and medium shareholders through enabling them to escape the share-locked decision making of a company and retain their investment, freeing them from the shackles of a minority vote.

According to the aforementioned Article, the repurchase shall be divided into two procedures, one is negotiated repurchase and the other is litigation repurchase.

The negotiated repurchase shall be the prepositive procedure of the litigation repurchase, which means only after the shareholder votes against a resolution and the company fails to reach the agreement on the purchase of shares within 60 days of the date on which the relevant resolution is adopted at the meeting of the board of shareholders and then the shareholder vote against the resolution may initiate a legal action in the people's court within 90 days of the date on which the resolution is adopted at the meeting of the board of shareholders. In such litigation, the plaintiff shall be the shareholder vote against the resolution while the defendant shall be the company. However, there is no clear stipulation related to the repurchase price and how to deal with such shares in the current legislation.

On the other hand, such a system conflicts with the company's capital maintenance principle and the creditor's interests. Generally, the shareholder is not allowed to withdraw the capital contribution following the incorporation of the company.

The Capital Maintenance doctrine can be said to have been conceived out of some concern for the position of the creditors to a company, that the company must maintain a minimum amount of capital so that in the event of a winding up, the creditors could be satisfied. Resultantly, creditors would feel more secure and would thus lend to companies, encourage innovation and growth as the platforms could access debt financing. Consequently, share repurchases can be seen to subvert this matter, as shareholders could exit the company with their capital and leave the creditors in a difficult situation during winding-up.

Alongside ensuring that creditors' interests are not prejudiced by a return of share capital, there are further implications of a share buyback. These include protecting shareholders against abuse by directors who strengthen their voting power when the company buys back its shares or protecting against a manipulation of the share price by companies that may use share buybacks to prop up their share price.

However, the motive behind share buybacks as a method of protecting minority shareholders also has connotations for the Company's structure. By being able to repurchase its own shares, it can restructure and adjust its debt to equity ratio, enabling a more fluid and smoother management of capital, in and out of the markets. Furthermore, in privately held companies, buybacks provide a mechanism for dispute resolution without the need for members to raise their own funds to

tackle the dissenting shareholder. Additionally, smaller companies may find it difficult to locate capital initially and having the option to buy back shares may sweeten the deal to potential investors who can invest safely in the knowledge that there is a reduced risk. Lastly, one can argue that buybacks enable companies to avoid third-parties becoming part owners, which is particularly useful in family run businesses. Yet, this final point is of diminished importance as a result of Article 71 CL which imposes that an absolute majority must consent to the share transfer.

4.4 Board of Shareholders

As for the importance of the Board of Shareholders, we can gain a better understanding about this organ's role from analyzing its position, composition, the power of function, deliberation method and voting procedure.

A. **Position and Component**

In terms of the position, the Board of Shareholders is the highest organ of the LLCs.

In terms of the components, the LLCs' Board of Shareholder shall consist of all the shareholders limited to the maximum numbers of 50.

B. **Power and Function**

Under Article 37 of *Company Law*, the Board of Shareholders has "*the following powers and functions:*

(i) *To decide on the business policies and investment plans of the company;*
(ii) *To appoint and replace directors and supervisors that are not appointed from representatives of staff and workers, and to decide on matters concerning the remuneration of directors and supervisors;*
(iii) *To deliberate on and approve reports of the board of directors;*
(iv) *To deliberate on and approve reports of the board of supervisors or supervisors;*
(v) *To deliberate on and approve the proposed annual financial budgets and final accounts of the company;*
(vi) *To deliberate on and approve the profit distribution plans and loss recovery plans of the company;*
(vii) *To adopt resolutions on the increase or reduction of the registered capital of the company;*
(viii) *To adopt resolutions on the issuance of corporate bonds;*
(ix) *To adopt resolutions on matters such as the merger, division, dissolution, liquidation or transformation of the corporate form of the company;*
(x) *To amend the articles of association of the company;*
(xi) *Other functions and powers specified in the articles of association of the company*".

The last paragraph of the quoted Article allows the shareholders to make a decision as to the above mentioned topics directly, without convening the board of shareholders, provided that if they agree unanimously to a motion and have the decision in writing with the signatures and seals of all shareholders.

It is worth mentioning again that the Shareholders, by means of establishing the Articles of Association, can grant the Board of Shareholders with more power to decide on the specific matters which is significant to the company's development, such as the company's borrowing and lending activities shall be decided by the Board of Directors.

C. **Deliberation Method and Voting Procedure**

Article 39 of *Company Law* divides shareholders' meetings into *regular* and *extraordinary* meetings: the latter, to be convened for especially important decisions, must be requested "*by shareholders representing at least one-tenth of the voting rights, by at least one-third of the directors or by the board of supervisors or, where the company has no board of supervisors, by a supervisor*".

Under Article 40 of *Company Law*, the Shareholders Meeting shall be convened by the Board of Directors and presided over by the chairman of the Board of Directors. Where the chairman is unable or fails to perform his duties, the deputy chairman of the Board of Directors shall preside over the meeting. Where the deputy chairman of the Board of directors is unable or fails to perform his duties, a director shall be nominated by a majority of the directors to preside over the meeting. Where a limited liability company has no board of directors, the Shareholders Meeting shall be convened and presided over by the Executive Director. Where the Board of Directors or the Executive Director is unable or fails to fulfill its or his duty to convene a Shareholders Meeting, the Board of Supervisors or, where there is no Board of Supervisors, a Supervisor of the company shall convene and preside over the meeting. Where the Board of Supervisors or Supervisor does not convene or preside over such a meeting, shareholders representing one-tenth or more of the voting rights may convene and preside over the meeting on their own initiative.

Article 43 of *Company Law* specifies that any resolution made at the Shareholders Meeting on any revision to the company's Articles of Association, any increase or reduction of its registered capital, or any combination, division, dissolution or transformation of the company must be passed by shareholders representing two-thirds or more of the voting rights.

Apart from the mandatory voting procedures as set forth in the preceding paragraph, the shareholders can establish the deliberating method and other voting procedure in the Articles of Association, such as the Shareholders Meeting can be held via telephone and the shareholder representing 50% of the voting rights can pass a resolution, or even depending on the shareholder's negotiation, the Articles of Association can enable the minority shareholder to enjoy equal voting right or less disadvantage voting right by specifying how to calculate the shareholder's voting right (excluding the voting right based on the subscribed capital).

4.5 Shareholders' Agreements

The Company Law does not set forth any regulation as to shareholders' agreements; therefore, in some cases, the conditions for their validity and effectiveness are not quite clear. One must also consider that the topic of shareholders' agreements is still rather new in the Chinese legal debate, given that relevant possibilities to modify the default arrangement provided by the Law have only existed since 2005. In the following paragraphs, we will take into consideration some of the most common clauses contained in shareholders' agreements, in such a way as to examine their validity under Chinese Law.[3]

Shareholder agreements often provide for dividends preference. Before 2005, dividends necessarily had to be distributed proportionally to the capital contributions; the 2005 Company Law amendment has transformed this provision from a mandatory rule to a default one, applicable only where the articles of association do not expressly provide otherwise.[4]

Therefore, a dividend preference clause found in shareholders' agreements, although this is not expressly regulated, does find a legitimizing provision in the Company Law, provided that all shareholders are part of the shareholders' agreement.

Another aspect commonly regulated in shareholders' agreements is the proportion of voting rights and the voting methods in shareholders' meetings. It may occur that voting rights do not reflect the proportion of each shareholder's contribution. These medications to the default rules of the Company Law are tolerated by the Company Law, as long as they are provided for in the articles of association.[5] However, there are provisions regarding the voting method that the articles of association may not modify, such as the decisions on the most important company operations that require a qualified majority of shareholders representing at least two-thirds of the total voting rights (see Sect. 4.4).

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[3]See Pisacane (2012).

[4]See Article 34 of *Company Law*: "*Shareholders shall receive dividends in proportion to their paid-up capital contributions and, when a company increases its capital, they shall have a priority right to subscribe for the increased capital in proportion to their paid-up capital contribution, unless all shareholders agree not to receive dividends in proportion to their paid-up capital contribution or not to exercise the priority right to subscribe for the increased capital in proportion to their paid-up capital contribution*".

[5]Article 42 2013 of *Company Law*: "*Shareholders shall exercise their voting rights at meetings of the board of shareholders in proportion to their respective capital contribution, unless otherwise stipulated in the articles of association of the company*".

Paragraph 1 of Article 43 of *Company Law*: "*The method of deliberation and voting procedures of the board of shareholders shall be specified in the articles of association of the company, unless otherwise provided in the Law*".

The limitations are more stringent in the case of a Sino-foreign Equity Joint Venture. Under Article 33 of the PRC Sino-foreign Equity Joint Venture Law Implementing Regulations the following decisions require the unanimous consent of the board of directors present (the presence *quorum* for a board meeting is at least two-thirds of the directors): amendment of the articles of association of the joint venture; termination and dissolution; increase or reduction of the registered capital; and merger or division.

Given these provisions, it is very important for the shareholders to be precise when establishing modifications to the default legal rules.

Although Company Law has gradually enhanced the protection of minority shareholders, in many situations it is still advisable to negotiate special protection measures through shareholders' agreements. The validity of the clauses protecting minority shareholders must be evaluated on a case-by-case basis.

It is quite common to see shareholders' agreement regulating existing shareholders' right of first refusal in the event that a shareholder wishes to transfer its shares in the company (see Sect. 4.3). Where a shareholder wishes to transfer his shares in a limited liability company, article 71 CL imposes the following conditions: (i) an absolute majority of shareholders must give consent to the transaction (the Law does not reference to "shareholders *representing the majority of voting rights*"); (ii) where all conditions of the transfer are equal, existing shareholders will enjoy the first refusal right over individuals and entities from outside the company.[6] If the shareholders wish to modify the default arrangement established by the Company Law—for example giving up their right of first refusal—they must do so by inserting an express provision in the articles of association (see Sect. 4.3); a clause contained in a shareholders' agreement may not effectively waive the rights set forth in the Law.

Lastly, given that a shareholders' agreement falls within the definition of "contract" as defined by the PRC Contract Law, one has to take into account the general norms governing the invalidity of contracts contained in Article 52 thereof. Therefore, a shareholders' agreement will be invalid "*in any of the following circumstances:*

(i) *One party induced conclusion of the contract through fraud or coercion, thereby harming the interests of the State;*
(ii) *The parties colluded in bad faith to harm the interests of the state, of a collective or a third party;*
(iii) *The parties intended to conceal an illegitimate purpose under the guise of a legitimate act;*
(iv) *The contract harms public interests;*
(v) *The contract violates mandatory provisions of laws or administrative regulations*".

[6]See Article 71 2013 of *Company Law*.

4.6 Minority Shareholder Protection

A. **Introduction**

The protection of minority shareholders is one of the most important functions of Company Law, as outlined in Article 1 Company Law of the People's Republic of China (Revised in 2013), Company Law is purposes on 'protecting the legitimate rights and interests of … shareholders.' More so in light of the fact that minority shareholders can face opposition and oppression from the majority shareholders as well as the Board of Directors. This is particularly important in Chinese Listed Companies, where the minority shareholders are often individuals, who possess poor competence and corporate awareness. Simply put, these minority shareholders are concerned only with the dividends of stocks, they do not much care about the business operation of the listed company. As a result, they are easily deceived by controlling shareholders, suffering losses of interests. The purpose of this submission is to draw comparisons between Chinese mechanisms of protection with those of other jurisdictions, including UK and Hong Kong.

Withal, several commentators argue that the protection of the rights of shareholders is vital in enhancing corporate governance and mobilising an adequate vehicle for business,[7] as well as being a key pillar in the corporate governance regime.[8] In order to analyse the rights of shareholders and thus provide an evaluation, we must first identify the role that shareholders occupy within a company.

B. **Definition**

A minority shareholder can be defined as an equity holder in a firm who does not have the voting control of the company. The simplest example is of a two-shareholder company, one of which owns 60% and the other owns 40%, thus the 40% shareholder is a minority. Furthermore, there can exist companies where all of the minority shareholders, collectively hold 80% of the firm's equity, but are still classed as a minority since they, individually, cannot exert control.

C. **Role of Shareholders**

To understand the position of minority shareholders, we must first lay out the role of shareholders within a company. The Companies Law of the People's Republic of China in Article 4, stipulates that, 'the shareholders of a company, as capital contributors, have the right to enjoy the benefits of the assets of the company, make major decisions, choose managers etc. in accordance with the amount of capital they have invested in the company.' Furthermore, Article 37 of the provisions outlines the powers such shareholders can enjoy. Fundamentally, as per Article 36 which grants the board of shareholders the title of highest authority in a company, shareholders are responsible for the operational policy and investment

[7]Low and Selwyn (2002).

[8]Goo and Carver (2003).

plan of the company, controlling its direction either through resolutions or through their directors that they appoint.

D. **Importance of Minority Protection—Why is Minority Protection Important?**

Firstly, it is important for firm valuation, since strong protections for minority shareholders increased the perceptions that the firm has stronger corporate governance, which is more favourable in the eyes of investors. Consequently, this drives stock value up. In the same vein, should the legal protection be engineered and maintained at a higher level, investors would ultimately suffer less anxiety about investing, thus leading to more capital introduction in the financial market. Additionally, more capital in circulation means that the Chinese market would experience diversification of financial products and promote economic value. Resultantly, the national economy would further develop.

Moreover, the interests of shareholders are under threat from misappropriation of assets and funds by the executives who actually control the corporate entity. The 'agency cost problem' means that minority shareholders, with an insignificant shareholding, are helpless in the wake of executive actions, purely because their voting power is too weak to make a tangible change. Due to this, minority protection is essential to reassuring investors that, by taking on a minority share, they are protected and their interests are guaranteed. Without such a guarantee, capital is unlikely to flow well within those corporations, which would have a negative trickledown effect across the market.

In most cases, the Chinese law of companies only provides positive rights, that shareholders "shall have certain rights" or negative actions such that, "the directors shall not commit certain wrongs". Fundamentally, the law remains silent where defined and specific procedures for protection need to have been provided for the minority shareholders in order for them to exercise their rights or to seek remedies. Following this, the absolute majority rule further weakens the position of minority shareholders, particularly when faced with majority shareholder power. There are virtually no restrictions upon the majority shareholders' control of the shareholders' meeting, and certainly none that the minority shareholder can exercise in order to curtail the potential erosion of their own interests.

E. **Majority Versus Minority**

Overall, the majority shareholder(s) can use their voting power to eclipse the minority in the business, for example by controlling the direction of the company, adopting changes to the Articles of Association etc. Simply put, it is difficult for minority shareholders to participate in corporate operations. This is as a result of the traditional majority rule where majority shareholders in Chinese companies are able to exact control and influence any corporate proposal in favour of their private interests merely by voting in the shareholders meeting. Contrastingly, minority investors have little to no input in the company's decision-making process. Furthermore, it may arise that minorities have restricted access to crucial corporate

information, as a result of the controlling shareholders having the capacity to keep themselves informed through corporate executives appointed by them. With the exception of institutional investors, most minority investors lack the ability to acquire timely and updated information on how the company is functioning.

In a jurisdiction like China, where a concentrated shareholding structure is prevalent, the core issue is not the conflict of interests between executives and shareholders, as a result of the shareholders holding all the power, the core issue is in fact regulating this power. In this circumstance, the executives are performing in accordance with the will of the controlling shareholder. Therefore, the primary concern of Chinese corporate governance is that the majority shareholder, who is often one and the same as the controlling shareholder, is too powerful and can thus intervene in the day-to-day operation of the company. Resultantly, they would be able to make corporate decisions contrary to the interests of the minorities or of the company, in order to pursue private interests.

F. **Minority Protection in China**

It can be said that Chinese corporate governance is influenced by European and Anglo-American Nations, with elements of both a civil, statutised regime (such as Germany) being augmented by common law and equitable measures (such as Just and Equitable Winding up in the UK).[9] Unlike Anglo-American systems, however, China utilises a two-tier governance structure, consisting of a board of directors and a supervisory board.

Fundamentally, Chinese law guarantees certain shareholder rights, including the right to challenge the validity of shareholders' and board's resolutions, the right to sue wrongdoers by derivative action and the right to wind up a company. These rights are also accompanied by certain obligations on shareholders, for example, according to the Article 20 of Chinese Company Law 2005 (Revised 2013), shareholders are prohibited from abusing their rights to infringe upon the interests of the company or other shareholders. Whilst this may be a direct provision of principle, it is commonly relied upon by minority shareholders seeking to enforce their rights against majority shareholders. It should be noted that is a powerful provision if accepted by the court, for the shareholder who abuses their rights and as a result causes damage or loss to the company or other shareholders, they will be liable for compensation, essentially suspending their limited liability. This strength is bolstered by Article 21, which elaborates that the controlling shareholder, actual controller, director, supervisor and senior officer are prohibited from infringing upon the interests of the company through exercising their relationships or connections in a manner that would cause issue for the company. Again, this provision is very useful for minority shareholders, as the person that breaches it, assumes liability for the loss raised.

[9]Gu (2006).

Both of these provisions, if activated, provide some avenue for minority shareholders to enforce their rights and protect the interests of themselves and the company.

In addition, Article 33 seeks to eliminate information asymmetry between shareholders, for it provides the right to shareholders to inspect and review corporate documents such as the Articles of Association, shareholders' resolution or board resolutions as well as the company's accounting books. This information right is critical for shareholders, particularly as it is essential to governance that shareholders understand the financial health of their investment in the company. Further provisions that can protect minority shareholders are those found in Article 100, which confers the right for a shareholder of a limited liability company representing at least 10% of voting power to propose an interim shareholder meeting. To add, if the board of directors and board of supervisors refuse or otherwise fail to convene and preside over the shareholders meeting, the said shareholder can convene and preside over such interim shareholders meeting. For a minority shareholder, being able to call meetings and convene a board to create a dialogue with other organs of the company can be very useful for protecting their interests. However, as stated, this right is only available to a minority shareholder holding more than 10% voting power is entitled to exercise the right. Moreover, the right is rather weak when one observes that the 'request' can be refused by the by the management.

A final provision, whilst not protecting the interests of the minority in the company but rather allowing them to retrieve their capital and move elsewhere, is Article 74 which provides that a dissenting shareholder shall have the right for their company to purchase their shares. The article provides circumstances in which this can be the case, 'the shareholders of limited liability companies dissenting at the following shareholders meetings shall have the right to ask its company to purchase its shareholding at a reasonable price:

(1) the company does not distribute profits to its shareholders for five consecutive years during which period that the company records profits every year and meets the conditions set forth by this Company Law for profit distribution;
(2) the company merges or divides or transfers its major assets;
(3) where the business term/life of the company stipulated in the articles of association has expired or other dissolution events stipulated in the AOA arise, the shareholders meeting decides to revise the AOA to make the company survive.'

Further, if the dissenting shareholder's agreement is irreconcilable with the company regarding purchase of its shares within 60 days of the resolution, then they can sue to court within 90 days of the making of the resolution.

This provision provides an exit route for the shareholder, where their differences cannot be reconciled. However, there is a deficiency in the protection in the use of the term "reasonable price", since the law is silent on the definition. Thus, this remains a contentious place for negotiation, breeding a lot of disputes when it comes to that point.

G. Comparative Minority Shareholder Protection

In this section, we will consider the protection of minority shareholders in China that have counterparts, specifically derivative action and Directors' Duties. By analysing the Chinese measures in context, we can accurately analyse the level of protection offered as well as seeing where the Chinese law can improve. From an advisory point of view, the comparative study is instructive in what factors the minority shareholders should be aware of, particularly any deficiencies identified in definitions or procedures.

Whilst both the United Kingdom (UK) and Hong Kong (HK) utilise a common law system, with the latter being heavily influenced by the former, China utilises a Civil Law system augmented by guiding cases of the People's Supreme Court. Thus, whilst the geo-political proximity of HK and China is very close, their structures of Corporate Governance vary vastly. In HK, the common law system follows English traditions, with the recent amendments to the Hong Kong Companies Ordinance 2014 showing the depth and variety of extensive remedies available.

a. Derivative Action

Due to the doctrine of separation of ownership and management in common law jurisdictions, shareholders do not participate in the daily governance of the company. As a result, a derivative action can be made where the Company itself suffers a wrong (such as a breach of a director's duty) but the directors choose not to pursue. The claim is made in the name of the company by a shareholder who is deriving the authority to sue. In such situations, where the minority shareholder has suffered no personal loss yet the company has suffered loss and this has correlated to a diminution in the value of the minority shareholder's interest, the appropriate remedy is to bring a derivative action.

In the UK, it has been traditionally difficult for shareholders to take corporate litigation for the company under the proper plaintiff rule.[10] This rule establishes that, because the wrong is done to the company, and that the company is a separate legal personality, the company is the proper claimant in a suit for the recovery of damages. Lowry and Dignam[11] observe that the judiciary's reluctance to interfere with corporate management decisions results in a particularly weak position for minority shareholders within the company's matrix. Moreover, Payne argues that shareholders' litigation is designed to be convoluted and obscure to prevent vexatious litigation.[12] With this in mind, the Companies Act (2006) (CA 2006) made it somewhat easier for derivative claims to be made under the statutory regime than from the common law scheme.

Under Chinese law, standing to sue is governed by Article 151 of the Company Law of the People's Republic of China (Revised in 2013). To initiate a derivative

[10]Foss v Harbottle (1843) 2 Hare 461.

[11]Lowry and Dignam (2003).

[12]Payne (2005).

claim, one needs to be a shareholder holding 1% of the total shares for 180 consecutive days. When compared to the UK, s260 CA 2006, where standing is granted immediately to any shareholder, we can see that under Chinese law, particularly in listed companies, minorities are practically excluded from the protection, for it is possible for minorities to hold less than 1% and thus be unqualified for the *locus standi*.

Furthermore, the pre-trial procedure for Chinese claims has a demand requirement, necessitating that the aggrieved shareholder submits a request to proceed with a claim to the People's Court. Moreover, the shareholder can only proceed upon the rejection or expiry of 30 days after the written notice, should the relevant authority not want to pursue the claim. When compared to the specificity outlined in the UK system, one can observe that the Chinese procedure is less than optimal for minority protection. The UK legislation adopts a two stage approach, requiring, under s261, for the shareholder to first establish a prima facie case, that the company has a good cause of action and this arises out of default, breach etc.,[13] followed by a full hearing. During the hearing, the court will exercise s263 analysis, firstly by establishing whether any of the mandatory or discretionary bars to standing apply to the case, followed by the acceptance of views of other company members not involved in the litigation. The UK system enables a full analysis of the facts and a cross-examination of the situation, allowing shareholder protection to be given adequate limelight. Comparatively, the Chinese system is restrictive and promotes a difficult procedure to follow.

Lastly, under both UK and Chinese laws, the scope of defendants is relatively similar, with China's Article 152 and 153 allowing company members and others that enabled the malpractice, and the UK, under s260(3), allowing pursuit of any director who breached their duties, including former and shadow directors (s260(5)) and third parties who dishonestly assist a director to breach duties.

Certainly, under the Chinese legislative scheme, in most cases, the alleged wrongdoer is a director, the majority shareholder or a certain related third party. Thus, any compensation from the lawsuit belongs directly to the company. The ultimate aim of the law is to curtail the agency costs and safeguard the interests of shareholders. If the actual controller, director or majority shareholder has failed to take adequate measures against the wrongdoer or has acted improperly in an existing claim, the shareholders of the company are permitted to initiate a claim.

Although China may not follow the *locus standi* requirements of common law jurisdictions, similar to Germany, the most significant reason as to why derivative action is uncommon in the Public Listed Companies is because of the restriction placed upon minority shareholders in joint stock limited companies (JSLC). As an equivalence, they can be compared to public companies in common law jurisdictions. Initially, a shareholder must hold 1% of the total share value of the company in order to have standing to bring forward a derivative action. A further issue is that the shareholder must have held these shares for 180 days. This is made no better by another ambiguity as to whether the legislation requires the applicant to be a

[13]Iesini v Westrip Holdings Ltd [2009] EWHC 2526 (Ch).

shareholder at the time the action is filed, or whether they could have been a former shareholder who has suffered a wrong.

By the same token, even where a shareholder holds 1% in any company, listed or otherwise, they face further barriers. Judges in China appear to be more concerned with the procedure than assessing whether another party's actions are unfairly detrimental. For example, in Long Jinwen v Zhonghua Accountant Firm, the applicant's attempt to view the audited company books was rejected in spite of their adherence to the request requirements. Subsequently, the company rejected their request on basis that the applicant lacked an accounting background, an argument which was accepted by the judge.

Shareholders are required to make a written request to the supervisory board to launch an action against a manager or directors of the company, or a written request to the managerial board if they are aggrieved by the supervisory board. In Yu Huihui v Yu Zhenxian, the applicant brought a derivative action without fulfilling the procedures. The applicant did not submit a written request, as such a shareholder considered the claim to be a special 'emergency' case. Fundamentally, the court only dismissed procedural grounds, that the application was defective in its preliminary procedure.

The difficulty arises, therefore, in the treatment of precedents in Chinese law. Overall, the cases are not given the same weight as the cases in many common law jurisdictions. Judges generally do not subscribe to these precedents when they make their decision, hence even if a minority shareholder has been successful on a point of law, another judge is not required to follow the ratio decidendi in that case. This is due to the fact that Chinese law has very strong civilian (mainly German) influence. In fact, the German Civil Code was copied into Chinese law in the latter years of the Qing dynasty.[14]

The extent of this division, between procedure and substance and between precedence and civilian law, can be seen in the following two cases. In Shunde Zhaoyu Electronic Hardware[15] the derivative action was quashed because the applicant failed to satisfy the 'demand.' Alternatively, in 2006, the court decided to affirm a derivative action in the Beijing Aeronautical case despite the fact that no demand had been made to a corporate body.[16]

Lastly, another reason for the lack of success or volume of Chinese derivative claims relates to the significant expense of self-funding the lawsuit. A Chinese minority shareholder does not have the option to seek protection of a contingency fund. Such a fund, used in the United States, is a fund for unexpected outflows and

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[14]Braendle (2006).

[15]Zhao Yu v. Zhou Yuchao re: Shunde Mun. Zhaoyu Elect. Hardware Co. Ltd. (Guangdong Province Foshan Municipal Shunde District People's Court (2006) shun fa miner chuzi No. 02196; on appeal Guangdong Province Foshan Intermediate People's Court (2007) fo zhong fa miner zhongzi No. 348).

[16]Lin Yu v. Aeronautical New Concept Science & Tech. re: Beijing Aeronautical City Tongzhi Nengka Engineering Co. Ltd. (Beijing Municipal Haidian District People's Court (2006) hai min chuzi No. 08927).

expenses of a company. Furthermore, China has the requirement of 'filing fees.' The fee is determined on a 'sliding-scale' with a 2.5% maximum rate for cases of RMB 10,000 or less, and 0.5% as a minimum rate for cases RMB 20 million or more. Despite the losing party generally being liable to compensate the winning side's filing fee, the plaintiff is required to provide it upfront. As a result of the significant potential cost involved, minority shareholders, who are usually individuals lacking experience as aforementioned, cannot engage in this mechanism to enforce their rights.

b. **Directors' Duties**

As with HK and UK Law, Chinese law mandates certain duties, functions and obligations that the directors of companies, of any size, must adhere to. Breach of these provisions can entail civil liability, administrative and even criminal sanctions. However, one would be correct to point out that the duties are owed to the company and not the shareholders and thus why do these duties matter for shareholder protection? Fundamentally, a key cause of action for a derivative claim is the breach of a duty and thus having well-defined and clearly demarcated duties that a director must follow can enable shareholders, majority and minority, to easily point to an instance in which the duty was breached. Furthermore, the duties prevent the uncontrolled or unmonitored abuse of director power which can diametrically oppose the interests of the company vis a vis the shareholders' interests.

In the UK, the court confirmed in the case of Re Smith & Fawcett Ltd that, 'a director is to act in what he or she genuinely believes to be the best interests of the company, rather than what the court may decide to be the best interests of the company.'[17] Such an approach has been codified into a statutory scheme which took the duties from common law, owing to the objectives of improving clarity and comprehensibility due to the complex and often unnecessarily complicated common law system. Under s170(1), the duties are owed to the company and thus the company is the proper claimant. Example duties include s171 with the duty to act within the powers conferred, s172 to promote the success of the company and s175 to avoid conflicts of interest. Moreover, under s232 directors cannot contract out of them nor be exempt from them, lending the duties nicely to a powerful regime of enforcement and protection.

Under the Company Law of the People's Republic of China (Revised in 2013), Article 147 states that Directors shall, 'abide by laws, administrative regulations and the articles of association of the company, and have a fiduciary obligation and obligation of diligence to the company.' Further, Article 148 lays out a series of acts that Directors and managers shall not do. We can see therefore, that the UK and Chinese duty schemes are similar, in that they both impose absolute duties and forbid the abuse of powers. However, in China, as a result of the lack of case law tradition, there remains uncertainty about the operation of these duties in practice.

[17] Re Smith & Fawcett Ltd [1942] Ch 304 (CA).

Consequently, it is difficult for shareholders in China, particularly minorities, to determine whether a director has breached his duties and thus whether they are empowered and justified in being able to bring a lawsuit against him. Yet, this trend of uncertainty in court treatment of duties is not unique to China. Even the courts in the UK are reluctant to second guess directors, if there has been no apparent or obvious self-interest driven action or breach of duty, the courts will require heavy persuasion to find for the claimant.

H. Summary

Resulting from their inability to efficiently supervise management executives as a result of their lack of power to call for a shareholders' meeting and raise motions, minority shareholders are in a weak position when faced with the majority shareholders who have their power enshrined in the absolute majority rule. This is not aided by the derivative action claim, which, whilst the litigation mechanism was introduced under the Chinese company law (2005 version) via the incorporation of overseas corporate governance models, in reality, it is worth noting that the deficiencies, both in the requirement of 1% equity and the costly procedures, retract some effectiveness of the protection mechanisms.

Moreover, as compared with UK corporate governance, we can see that the Chinese Directors' Duties are less nuanced. Whilst the UK has several, explicit positive duties the Directors of company owe to the company, Chinese corporate governance law leaves several vague definitions of positive duties. As a result, it is difficult for shareholders to definitively say when a director has breached their duties, particularly as there is no interpretative help from the courts in the form of case law. However, the aim of this article was not to conclude that China should adopt a case-precedence system.

Simply put, the Chinese system lacks intricate details in certain areas and thus, by adopting more authoritative statements and approaching matters in a more nuanced way can alleviate many of the issues identified hitherto. One such example would the exploration of directors' duties, evaluating terms such as 'obligation of diligence' and identifying standards that directors should be held to.

Additionally, reform should focus on improving the shareholders' substantive rights as this is the fundamental countermeasure to the abuse of other rights in the company, such as implementing greater participation rights in decision-making. One potential reform would be changing the ability of minority shareholders to introduce motions at the shareholder's interim meeting, changing the limitation from voting share to temporal on how meetings are called. By enabling greater accessibility to decision making processes, there is more potential for oversight of the procedure, yet, the minority status of the shareholder does not jeopardise the company or incur deadlock.

Further, owing to the limitations of the legislative mechanisms such as the complex litigation costs, it is difficult for minority shareholders to file a suit to claim the loss and protect their interests. Therefore, adopting alternative cost procedures can help more claims to be brought and would enable the system to serve as an

enforcement mechanism rather than a difficult and ineffective process. Additionally, facilitating more claims would not increase the chances of vexatious litigation due to the stringent conditions already burdening potential plaintiffs. On this point, above all, greater clarity is needed. The lack of case precedence means that derivative claimants are in an unknown position when facing the courts as it is difficult to predict how the judiciary will react to the claim since there is no defined case path.

4.7 Summary

As a summary, in order to guide the company to efficiently and legally operate subject to the shareholders' plan for the LLCs' management and business operation, the shareholders, as the owner of the LLCs, shall greatly exploit the Board of Shareholders and Articles of Association to realize their plan, furthermore, the shareholders should learn their legal rights and what remedies they are entitled to claim for under Company Law as the measures for corporation governance.

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Chapter 5
Legal Representative

5.1 Overview

All companies incorporated in the People's Republic of China, regardless of whether they are foreign or domestically invested, must appoint a legal representative. Given that the company is not a person, it cannot do anything by itself, so it finds a person called a legal representative to act on behalf of it. Unlike the principal-agent relationship which can be proven by a Power of Attorney, the company is required to register the name and file the specimen of its legal representative with the competent company registration authority.

On one hand, based on the principle that the legal representative represents and acts on behalf of the company, their management actions are considered *actions of the company*; the company, therefore, undertakes civil liability for all actions made by the legal representative in its name and on its behalf.

On the other hand, while the legal representative is capable of binding the company with the civil liability, they can be generally held responsible for the company's activities in violation of laws or administrative regulations and even criminal activities.

5.2 Qualification of Legal Representative

The requirements set forth in Article 146 of *Company Law* as to the appointment of directors and senior management personnel restrict the subjects that may be appointed as legal representative. Under this Article, "*None of the following people may serve as a director, supervisor or senior officer of a company: (1) Any person who does not have capacity for civil acts or who has limited capacity for civil acts; (2) Any person who has been convicted of any criminal offense in the nature of corruption, bribery, encroachment of property, misappropriation or disrupting the*

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G. Pisacane, *Corporate Governance in China*, China Law, Tax & Accounting, DOI 10.1007/978-981-10-3911-9_5

order of the socialist market economy and five years have not elapsed since the expiration of any penalty imposed, or any person who has been deprived of his political rights due to committing a crime and five years have not elapsed since the expiration of the penalty imposed; (3) Any director, factory director or manager of a company or enterprise having been declared bankrupt and liquidated in circumstances where he was personally responsible for the bankruptcy of such company or enterprise, and three years have not elapsed since the bankruptcy and liquidation of such company or enterprise was completed; (4) Any legal representative of a company or enterprise which has had its business license revoked and has been ordered to close down due to any violation of law in circumstances where the former legal representative was personally liable for the revocation of the business license and three years have not elapsed since the date of revocation; or (5) Any person who has a significant amount of personal unpaid due debts. Any election or appointment of any director, supervisor, or senior officer made in violation of the provisions the preceding paragraph shall be invalid. Any existing director, supervisor or senior officer falling within the circumstances specified in paragraph 1 shall be dismissed from his post".

Furthermore, under *Order of the State Administration of Industry and Commerce on Releasing the Administrative Provisions on the Registration of Legal Representatives of Enterprise Legal Persons*, it specifies which persons cannot serve as the legal representative, which is that in any of the following circumstances, the person concerned shall not assume the post of legal representative, and the enterprise registration authority shall not approve the registration: (1) the person has no capacity or has limited capacity for civil conduct; (2) the person is receiving a criminal penalty or criminal coercive measure; (3) the person is wanted by a public security organ or a state security organ; (4) the person has been sentenced to a criminal penalty due to the crime of corruption and bribery, crime of property violation or the crime of disrupting the order of socialist market economy, with the execution period having expired for less than five years; the person has been sentenced to a criminal penalty due to any other crime, with the execution period having expired for less than three years; or the person has been deprived of political rights due to a crime, with the execution period having expired for less than five years; (5) the person once acted as the legal representative, or a director or manager of an enterprise which has been bankrupted for less than three years due to improper operation, and bore individual liability for the bankruptcy; (6) the person once acted as the legal representative of an enterprise with its business license revoked for less than three years due to an illegal behavior, and bore individual liability for the illegal behavior of the said enterprise; (7) the person is in debt of a large amount and fails to pay off the debt which has matured; or (8) the person is in any other circumstance under which any law or the State Council prescribes that he shall not hold the post of a legal representative. Where the qualification for the legal representative is obtained in violation of the Provisions, by concealing factual situation or in a deceptive way, the enterprise registration authority shall order to make rectifications and impose a penalty of no less than CNY10,000 to no more than

CNY100,000; if the circumstance is serious, the enterprise registration shall be canceled and the business license for the enterprise legal person shall be revoked.

Under *Interim Regulations on Enterprise Information Publicity*, the legal representatives and responsible person of enterprises listed on the list of seriously violating enterprises shall not be the legal representatives or responsible person of other enterprises within three years.

Lastly, in respect of some industries particularly involving the human being's health and life or public interest or national security, in the case that the company's business license is revoked because of its activities in violation of administration regulation, its legal representative or responsible person cannot serve any management position or even work in the same industry within a statutory period of time as of the day that the company gets the administrative punishment or even his whole life, for example, under *Food Safety Law of the People's Republic of China (Revised in 2015)*, where the food producers and traders whose licenses have been revoked, their legal representatives and directly responsible persons in charge as well as other persons directly liable shall not engage in the food production and trading management or act as food safety managers in food production and trading enterprises within five years as of the date when the decision on the penalties is made, Whoever has been sentenced to fixed-term imprisonment or above for food safety crimes shall not engage in food production and trading management for the whole life long, nor act as a food safety manager in any food production and trading enterprise. Where food producers and traders employ employees in violation of the provisions of the preceding two paragraphs, the food and drug administration's of the people's governments at the county level or above shall revoke their licenses.

As a summary, when the shareholders choose the legal representative for the LLCs they shall be cautious about the candidates' qualification, otherwise, the LLCs can be imposed under penalty.

5.3 Powers of Legal Representative

Under *General Principles of Civil Law of the People's Republic of China*, there is a general clause confirming the legal representative's power as "*In accordance with the law or the articles of association of the legal person, the responsible person who acts on behalf of such legal person in the exercise of its functions and powers shall be its legal representative*." Furthermore, under *Administrative Regulations of the People's Republic of China on the Registration of Enterprise by Legal Persons*, it also contains a principle clause as "*The legal representative of an enterprise legal person, which has been registered after examination and approval by the competent registration authority, shall be the signatory who exercises functions and powers on behalf of the enterprise. The signature of the legal representative shall be filed with the competent registration authority for the record*". Accordingly, we can see that a legal representative has an extremely wide range of powers, as well as the right to represent the company before third parties.

By way of example, a legal representative may:

- act in order to preserve the assets of the company;
- participate in and chair both shareholders' meetings and meetings of the board of directors;
- act on behalf of the company relying on a Power of Attorney;
- authorize legal representation in the case of disputes;
- carry out all transactions falling within the nature and the business scope of the company
- act as a keeper of the company seals (so-called *chops*: see Chap. 11).

Although *Company Law* does not clearly define the functions of a legal representative, in terms of the LLCs, it mentions that the Articles of Association shall contain the clause regarding the company's legal representative. Accordingly, the shareholder can specify the legal representative's power and even limit his power in the Articles of Association.

Furthermore, in terms of the Legal Representative's influence on the company's incorporation and alteration, please note, the Legal Representative needs to sign relevant application to the competent company registration authority, in other words, lacking in the legal representative's signature, it cannot proceed the incorporation and alteration (such as the company name change, business place change, business scope change, registered capital change) of the company.

5.4 Company's Liability for Legal Representative's Actions

In terms of the Legal Representative's actions for the company's management and business operation, those actions are treated as the actions of the company, in other words, the company shall be liable for the Legal Representative' s foregoing behaviors to a third party.

As for the civil liability of the company, Article 43 of the PRC General Principles of Civil Law stipulates as follows: "*An enterprise legal person shall bear civil liability for the activities carried out by its legal representative and by the rest of its personnel*".

Generally speaking, a condition for the company to be held liable is that the legal representative has acted unlawfully while performing his functions. However, the PRC Contract Law stipulates that a company may be held liable for the correct implementation of an agreement entered into by the legal representative on behalf of the Company with a third party, even if such agreement does not strictly fall within the scope of the functions of the legal representative.

Article 50 of the PRC Contract Law stipulates: "*Where the legal representative or the person in charge of a legal person or an organization of any other nature enters into a contract acting beyond the scope of his authority, such act of*

representation shall be valid, unless the other party knew or should have known that he was acting beyond the scope of his authority". Where a third party has believed in good faith that the legal representative of the company was acting within the limits of his authority at the moment in which he signed the contract, the company will be held liable for the action of the legal representative regardless of whether or not he was endowed with the relevant powers.

5.5 Legal Representative's Liability for Company's Actions

Under *General Principles of Civil Law of the People's Republic of China*, there is a general clause directly regarding the legal representative's liability incurred by the Company's actions, specifically, under any of the following circumstances, an enterprise as legal person shall bear liability, its legal representative may additionally be given administrative sanctions and fined and, if the offence constitutes a crime, criminal responsibility shall be investigated in accordance with the law: (1) conducting illegal operations beyond the range approved and registered by the registration authority; (2) concealing facts from the registration and tax authorities and practicing fraud; (3) secretly withdrawing funds or hiding property to evade repayment of debts; (4) disposing of property without authorization after the enterprise is dissolved, disbanded or declared bankrupt; (5) failing to apply for registration and make a public announcement promptly when the enterprise undergoes a change or terminates, thus causing interested persons to suffer heavy losses; (6) engaging in other activities prohibited by law, damaging the interests of the state or the public interest.

Furthermore, under *Administrative Regulations of the People's Republic of China on the Registration of Enterprise by Legal Persons*, there is also a general clause directly regarding the legal representative's liability incurred by the Company's actions, specifically, the registration authority may, in light of the circumstances involved, penalize an enterprise legal person by warning, fine, confiscation of illegal earnings, suspension of business for remedial action, or revoking the Business License for Enterprise Legal Person, if it falls under any of the following circumstances: (1) Where actual facts are concealed or there is fraud in its registration or the enterprise commences business activities without being approved and making a registration; (2) Where major matters involved in its registration are changed without permission or the enterprise carries out business activities beyond such a scope of business as is approved and registered; (3) Where the enterprise fails to go through deregistration or submits its annual inspection report in accordance with relevant provisions; (4) Where the enterprise forges, alters, leases, lends, transfers, sells or reproduces without permission the Business License for Enterprise Legal Person or any duplicates of such License; (5) Where the enterprise withdraws or transfers capital or conceal property in order to dodge

any liabilities; or (6) Where the enterprise carries out any illegal business activities. When penalizing an enterprise legal person in accordance with the above provisions, the competent registration authority shall pursue its legal representative for administrative and economic liability according to circumstances involved in any violations of the law; where the criminal law is violated, judicial organs shall pursue the legal representative for criminal liability in accordance with the law.

As a summary, directly speaking, the legal representative can take the administrative liability and criminal liability for the company's actions in violation of laws or administrative regulations or criminal actions. Apart from the liability, the legal representative can be restrained to exit the country.

5.5.1 Administrative Liability

The forms of the administrative liability mainly culminate in an administrative fine or position dismissal, what's worth mentioning is that normally, the legal representative is not directly held for administrative liability, but the major person in charge (or called as main responsible person) can be held administrative liability to the company's acts in violation of laws and regulations which can be attributed to his dereliction of duty.

Although lacking in a united definition for Major Person in Charge of the companies in different business, at least the Major Person in Charge shall be the one engaging in the companies' management and business operation. Considering the legal representative role is served by either the director or one of the senior management personnel, in practice, the authorities can find it easy to hold the legal representative as the major person in charge.

For example, under *Work Safety Law of the People's Republic of China (Revised in 2014),* if the major person-in-charge of a production or operation entity fails to perform the duty of administering work safety according to the provisions of the Law which resulting in a work safety accident, the punishment of removal from his or her office is to be imposed thereon. Moreover, the work safety regulatory departments shall impose fines on them according to the following provisions: (1) in the event of an ordinary accident, fines equal to 30% of the annual revenue of preceding year; (2) in the event of a relatively serious accident, fines equal to 40% of the annual revenue of preceding year; (3) in the event of a serious accident, fines equal to 60% of the annual revenue of preceding year; and (4) in the event of an especially serious accident, fines equal to 80% of the annual revenue of preceding year.

5.5.2 Criminal Liability

In common with the administrative liability, Chinese law does not hold the legal representative of a company to be generally liable for the crimes of the company. However, in some cases, the PRC Criminal Law sanctions and holds responsible not only the company but also the "person in charge" or the person "directly responsible" for any crimes perpetrated. Article 31 of the PRC Criminal Law stipulates that "A*n entity responsible for a criminal action shall be fined. The person in charge and other personnel directly responsible shall also undergo criminal sanction. Where the Special Provisions of this Law or other laws contain different provisions, such provisions shall prevail*".

It is a commonly held opinion that this provision also applies to the legal representative of a company. The crimes for which the legal representative may be held liable together with the company include, by way of example, crimes involving capital contribution operations, financial statements, the production and sale of toxic or harmful food products, etc.

Article 153 of the PRC Criminal Law provides us with an example of joint liability of the legal representative and the company, stipulating that: "*Where an entity commits offences under the preceding paragraph* [refers to smuggling]*, it shall be punished with a fine, with persons directly in charge and other directly responsible persons being sentenced to no more than three years of fixed-term imprisonment or criminal detention; where the case is of a serious nature, to no less than three years and no more than ten years of fixed-term imprisonment; where the case is extremely serious, to no less than ten years of fixed-term imprisonment*".

An example case is that of Zhang Jinghai, the legal representative of a WOFE named Dong Xing Hotel. Zhang Jinghai applied for importing 4 duty-free vehicles in the name of the company self-use during the years from 1992 to 1994. Later he sold such vehicles to other companies for profit-making under the circumstances that have not fulfilled the customs duties before the transactions. According to the related laws and regulations in China, such duty-free imported vehicles shall not be sold in domestic before filing the application and paying the customs duties to the Customs. Zhang violated knowingly and made the company evade the payable duties with a relatively large amount of RMB384, 000, thus constituted a crime of smuggling. Therefore the court sentenced him to five years of fixed-term imprisonment and the penalty of RMB400, 000.

However where a company commits a crime and its legal representative is not directly involved in the said crime, the legal representative will not be held criminally liable for the crime unless the crime is not connected to the fulfillment of his duties in the company.

5.5.3 Restrictive Measures on Legal Representative

The legal representative of a company can also be subject to restrictive measures.

Under *Interpretation of the Supreme People's Court on Certain Issues Concerning the Application of Enforcement Procedures under the Civil Procedure Law of the People's Republic of China*, where an enforcee is an institution, its legal representative, main personnel in charge or personnel directly responsible for influencing the performance of its obligations may be restrained from leaving the territory.

Furthermore, under *Law of the People's Republic of China on the Administration of Tax Levying (Revised in 2015)*, where a defaulting taxpayer or its legal representative needs to leave China, he shall settle the amount of tax payable or late payment fines or provide a guarantee to the tax authorities before leaving the country. If the taxpayer neither settles the amount of tax payable or late payment fines nor provides a guarantee, the tax authorities may notify the immigration authorities to prevent the taxpayer or its legal representative from leaving the country.

Chapter 6
Directors and Board of Directors

6.1 Overview

It is mandatory for the LLCs to establish the Board of Directors (or instead appoint an Executive Director).[1] Generally, the Board of Directors is created by the Board of Shareholders and is responsible for the operation of management and business subject to the instructions of the Board of Shareholders. The Board of Directors is also part of the governance structure which should be governed as well in order to make the LLCs achieve the sustainable and profitable business.

6.2 Qualification of Directors

Under Article 146 of *Company Law*, a person shall not serve as a company's director if he is: (1) a person with no or limited capacity for civil acts; (2) a person that was sentenced to criminal punishment for the crime of corruption, bribery, encroachment of property, misappropriation of property or disruption of the order of the socialist market economy, and not more than five years has elapsed since the expiration of the enforcement period; or a person that was deprived of his political rights for committing a crime, and not more than five years has elapsed since the expiration of the enforcement period; (3) a director, factory director or manager of a company or enterprise liquidated upon bankruptcy that was personally responsible for the bankruptcy of the company or enterprise, and not more than three years has elapsed since the date of completion of the bankruptcy liquidation; (4) the legal representative of a company or enterprise that had its business license revoked and

[1]Article 51 of *Company Law* gives to small companies the option to appoint an executive director instead of a Board of Directors. The said executive director can also assume the role of director of the company. Moreover, the functions and the powers of the executive director are specified in the Articles of Association.

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G. Pisacane, *Corporate Governance in China*, China Law, Tax & Accounting, DOI 10.1007/978-981-10-3911-9_6

had been closed down by order for violation of law, for which such representative bears individual liability, and not more than three years has elapsed since the date on which the business license of the company or enterprise was revoked; and (5) a person with a comparatively large amount of personal debts due and unsettled. If a company elects or appoints a director against *Company Law*, such election or appointment shall be invalid. If a director falls under the circumstances as aforementioned during his term of office, the company shall dismiss him from his office.

Particularly, in the case of setting up a Board of Directors, under Article 44 of *Company Law*, where the LLCs are established by two or more state-owned enterprises or two or more other state-owned investment entities, the Board of Directors shall contain the member who is (are) the representative (s) for the employees.

In terms of the creation of the directors, the directors can either be individually appointed by each shareholder or jointly appointed by the entire board of shareholders, subject to the Articles of Association, or elected among the employees via a democratic procedure such as the Employee General Assembly. Particularly, in the case of a Sino-foreign Joint Venture Company, according to EJV Law, the Chinese investor and foreign investors shall decide the number of members in the Board and respectively appoint the directors from each side in proportion to their shareholdings percentage.

Under *Administrative Regulations of the People's Republic of China on Company Registration (Revised in 2014)*, the names and any change of directors shall be filed and recorded with the competent company registration authority, otherwise, the authority has the discretion to impose a fine on the company.

6.3 Directors' Obligations

Under *Company Law*, the directors' obligations can be classified into those subject to the general requirement and those regarding the forbidden actions.

A. **General Requirement on Obligations**

Under Article 147 of *Company Law*, the directors of a company shall comply with laws, administrative regulations, and the Articles of Association and shall owe duties of fidelity and due diligence to the company.[2]

[2]In the case of Beijing Yanjing Construction Engineering Co., Ltd. versus Yang Guoqing Regarding the Damages of Company Benefit, the Court held that a director shall abide by laws, administrative regulations and the articles of association of the company, and have a fiduciary obligation and obligation of diligence to the company (Article 147 CL). Where a director violates the provisions of laws, administrative regulations or the articles of association of the company in the execution of his duties, thereby causing losses to the company, he shall be liable for compensation (Article 149 CL). The defendant in this case, Yang Guoqing, the director of the company, failed to take effective and legal actions to solve the problems of the company business

Under Article 150 of *Company Law*, where the Board of Shareholders requires any director to attend the meeting as a non-voting attendee, he shall do so and shall answer the shareholders' inquiries. The directors shall faithfully provide relevant information and materials to the Board of Supervisors or to the supervisor(s), and may not obstruct the Board of Supervisors or any supervisor in the exercise of its or his power and function.

B. **Obligation regarding Forbidden Actions**

Under Article 21 of *Company Law*, the directors of a company shall not make use of their affiliations, contacts or personal relationship to harm the interest of the company nor use employ such connections to the detriment of the company. This is expanded, explicitly, under Article 147 of *Company Law*, to state that the directors shall not take any bribe or another illegal gain by taking advantage of his position or misappropriate company assets for personal use.

Under Article 148 of *Company Law*, the directors shall not commit any of the following actions: (1) to misappropriate the company's funds; (2) to deposit the company's funds into an account under his own name or any other individual's name; (3) Without the consent of the shareholders' meeting, shareholders' assembly, or the board of directors, to loan the company's funds to others or to provide any guaranty to any other person by using the company's property in violation of the articles of association; (4) To enter a contract or to trade with the company infringing the articles of association or without the consent of the shareholders' meeting or the shareholders' assembly; (5) Without the consent of the shareholders' meeting or the shareholders' assembly, to seek for himself or any other person's business opportunities that belong to the company by taking advantages of his powers, or to operate for himself or for any other persons a business similar to that of the company for which he works; (6) to take for himself commissions on the transactions between others and the company; (7) Illegally disclosing the company's confidential information; (8) other acts inconsistent with the obligation of fidelity to the company.

Apart from the statutory obligations aforementioned, the shareholder can specify other obligations of the directors in the LLCs' Articles of Association according to their requirement on the directors, by means of which the shareholders can make the best use of the remedies provided by *Company Law*. Specifically, in the event that a director is in violation of his obligations as provided by the laws or administrative regulations or Articles of Association which causes the company to suffer loss, any shareholder of the LLCs is entitled to request the Board of Supervisors to file the lawsuit against relevant director. Should the Supervisors refuse or fail to file a

(Footnote 2 continued)

operation during his term of office, on the contrary, he took some inappropriate behaviors which lead to the company's difficulties in business operation and cause the economic losses to the company. Therefore, the Court sentenced that the defendant shall bear the liability for compensation as the director of the company.

lawsuit within 30 days of receiving a written request from the shareholder, the shareholder is entitled to file a lawsuit in his own name.

As an example regarding the Damages of Company Interests, we can see in the case of Shanxi Furong Trading Co., Ltd. versus Qingdao Hainuosi Group Co., Ltd. and Zhao Jianxun Shanxi Furong Trading Co., Ltd. Qingdao Hainuosi Group Co., Ltd. are the shareholders of Qingdao Zhongke Environmental Protection Technology Co., Ltd., and Zhao Jianxun is the director of Qingdao Zhongke Environmental Protection Technology Co., Ltd. The Court held that the plaintiff holds 8% of the shares of the company, so he is qualified to initiate a legal action in the people's court in its own name (Article 151 Paragraph 1 CL). Moreover, the plaintiff has submitted a written request to the supervisors of the company before the legal action but the supervisors have failed to take any action within 30 days of the date of receipt of the request. Therefore the plaintiff has already fulfilled the prepositive procedure (Article 151 Paragraph 2 CL), so the court held that the plaintiff is entitled to initiate such litigation.

6.4 Board of Directors

The following will illustrate the LLCs' Board of Directors in respect its position, composition, the power of function, deliberation method and voting procedure.

A. **Position and Component**

In terms of the position, *Company Law* specifies that the Board of Directors shall answer to the Board of Shareholders.

In terms of the component, under Article 44 of *Company Law*, the LLCs' Board of Directors shall consist of 3–13 members, among others, the Board shall appoint a president and may appoint a vice-president. What's worth mentioning is that the term of the directors, under Article 45 of *Company Law*, shall not exceed 3 years. When the term of office expires, a director may be reappointed and therefore serve consecutive terms, furthermore, if no re-election is carried out upon the expiration of the term of office or a director resigns during his term of office, resulting in the number of members of the board of directors being lower than the statutory number, the original director shall continue to perform his duties as director in accordance with laws, administrative regulations and the articles of association of the company until a newly elected director takes office.

B. **Power and Function**

Under Article 46 of *Company Law*, the Board of Directors of the LLCs shall *exercise the following functions and powers*:

(1) *To convene shareholders' meetings and to present reports thereto*;
(2) *To implement the resolutions made at the shareholders' meetings*;
(3) *To determine the company's business and investment plans*;

(4) *To formulate the company's annual financial budget plans and final account plans*;
(5) *To formulate the company's profit distribution plans and loss recovery plans*;
(6) *To formulate the company's plans on the increase or reduction of registered capital, as well as on the issuance of corporate bonds*;
(7) *To formulate the company's plans on merger, split, change of the company form, or dissolution,* etc.;
(8) *To decide on the establishment of the company's internal management departments*;
(9) *To decide on hiring or dismissing the company's manager and his remuneration, and, according to the recommendations of the manager, to decide on hiring or dismissing the vice manager(s) and the persons in charge of finance as well as their remuneration*;
(10) *To formulate the company's basic management system*; *and*
(11) *Other functions as specified in the articles of association*".

C. **Deliberation Method and Voting Procedure**

Under Article 47 of *Company Law*, a *meeting of the LLCs' board of directors shall be convened and presided over by the chairman of the board. If the chairman of the board is unable to or fails to perform his duty, a meeting shall be convened and presided over by the vice-chairman of the board. If the vice-chairman of the board is unable or fails to perform his duty, a meeting may be convened or presided over by a director jointly designated by half or more of the directors.*

Article 48 of *Company Law* specifies that the deliberation method and the voting procedures followed by the board of directors are indicated in the articles of association; in any case, each director may only have one vote. Particularly, in the case of a Sino-foreign Equity Joint Venture Enterprise, according to EJV Law, there is a mandatory provision stating that the resolutions regarding the following matters shall be adopted with the unanimous approval of the directors present at the Board Meeting: (1) amendments to the articles of association; (2) capital increase and decrease; (3) dissolution of the joint venture; (4) the mortgaging of assets of the joint venture; the merger, dissolution or transformation of the joint venture.

6.5 Summary

As a summary, the Board of Directors plays a significant role in the LLCs' corporation governance, the shareholders shall be cautious about the candidates for the position of director and about the establishment of the Articles of Association to specify the quorum to convene a Board Meeting and the Board of Directors' other power and function beyond the statutory ones and the effective creation of the board resolution. Furthermore, given the Board of Directors under the obligation to prepare the minute of the adopted decision and the directors present at the meeting

under the obligation to sign the minutes, the shareholders can make use of its statutory right to check the board resolution and determine whether the directors are properly performing their duties.

Chapter 7
Supervisors and Board of Supervisors

7.1 Overview

The *2005 Amendment to Company Law* marked the beginning of a new era, characterized by a new attention to corporate governance in Chinese companies. One of the main novelties of the new Company Law was the more incisive role and the mandatory nature of the company supervision organ, that is, the board of supervisors. The organ's purpose is to guarantee the correct application of the other corporate governance mechanisms and to check and prevent any violations of the law by the directors or senior officers of the company.

Until 2005, it was not mandatory to set up a supervisory organ, only companies set up after January 1st, 2006 had to appoint a supervisor or a board of supervisors upon incorporation; all companies incorporated before 2006 without a supervision organ had to introduce such an organ.

According to *Opinion for the Implementation of Certain Issues Concerning the Application of Laws in the Administration of Examination, Approval and Registration of Foreign-invested Enterprises* promulgated in 2014, the Sino-foreign EJV or CJV limited liability companies shall establish a board of directors as the company authoritative organ in accordance with the relevant laws and regulations, and other organizations of the company shall be stipulated in the articles of association as required by law. The organizations of the wholly foreign-invested limited liability companies and joint stock companies shall be established pursuant to the Company Law. According to the provisions of *Company Law*, a limited liability company and joint stock company shall establish a board of supervisors, only the limited liability company with few shareholders or of small size may appoint one or two supervisors instead of the board of supervisors. From that the supervisor system is a compulsory requirement of *Company Law* and there are no related special regulations under the law of foreign investment. Therefore, the foreign invested companies shall establish a supervisor system. The form (a board of supervisors or individual supervisors), the constitution (by election or appointment), term of office,

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G. Pisacane, *Corporate Governance in China*, China Law, Tax & Accounting, DOI 10.1007/978-981-10-3911-9_7

function and power and other issues shall be determined according to the articles of association on the situation of each company. Especially in the Wholly Foreign-Owned Enterprises, the board of supervisors becomes quite important in the complex system of checks and balances that characterize corporate governance in China. The board of shareholders, the board of directors (or the executive director) and the supervisors are different branches of one commercial structure. Each of the said organs has powers that it exercises in relation to the other organs, ensuring that no branch may have power and checks without being in turn subject to the power and checks of another organ. It is important to clarify that it is not the supervisory board's function to manage the company's business or to carry out commercial operations on the company's behalf but only to monitor that those whose function it does so in a correct and law-abiding manner. Therefore, the presence of an actual supervisory organ in the company guarantees that the investors, the shareholders, the employees and the stakeholders, in general, have the certainty that the company is being managed legally. The role of the supervision organ is seen as essential for the proper functioning of the company's corporate governance system and as marking a turning point in the process of increasing company transparency.

7.2 Qualification of Supervisor

Under Article 146 of *Company Law* as well, a person shall not serve as a company's supervisor if he is: (1) a person with no or limited capacity for civil acts; (2) a person that was sentenced to criminal punishment for the crime of corruption, bribery, encroachment of property, misappropriation of property or disruption of the order of the socialist market economy, and not more than five years has elapsed since the expiration of the enforcement period; or a person that was deprived of his political rights for committing a crime, and not more than five years has elapsed since the expiration of the enforcement period; (3) a director, factory director or manager of a company or enterprise liquidated upon bankruptcy that was personally responsible for the bankruptcy of the company or enterprise, and not more than three years has elapsed since the date of completion of the bankruptcy liquidation; (4) the legal representative of a company or enterprise that had its business license revoked and had been closed down by order for violation of law, for which such representative bears individual liability, and not more than three years has elapsed since the date on which the business license of the company or enterprise was revoked; and (5) a person with a comparatively large amount of personal debts due and unsettled. If a company elects or appoints the supervisors against *Company Law*, such election or appointment shall be invalid. If the supervisors fall under the circumstances as aforementioned during their term of office, the company shall dismiss them from their office.

Particularly, in the case of setting up a Board of Supervisor in the LLCs, under Article 51 of *Company Law*, it is mandatory for the Board to contain at least one

representative for the shareholders and for the Board's composition to be at least 1/3 constituted by members who are the representative(s) for the employees.

Lastly, also under Article 51 of *Company Law*, it makes clear that the directors and senior management personnel shall not serve as the supervisors.

In terms of the creation of the supervisors in the LLCs, the supervisors are either individually appointed by each shareholder or jointly appointed by the entire shareholders subject to the Articles of Association or elected among the shareholders or elected among the employees via a democratic procedure such as the Employee General Assembly subject to *Company Law*.

In common with the filing and recordation of the directors, the names and any change of the supervisors shall be filed and recorded with the competent company registration authority, otherwise, the authority has discretion to impose fine on the company.

7.3 Supervisor' Obligations

Under *Company Law*, the supervisors' obligation can also be classified into those subject to the general requirement and those regarding the forbidden actions.

A. **General Requirement on Obligation**

Under Article 147 of *Company Law*, the supervisors of a company shall comply with laws, administrative regulations, and the Articles of Association and shall owe duties of fidelity and due diligence to the company.

Under Article 150 of *Company Law*, where the Board of Shareholders requires any supervisor to attend the meeting as a non-voting attendee, he shall do so and shall answer the shareholders' inquiries.

B. **Obligation regarding Forbidden Actions**

Under Article 21 of *Company Law*, the supervisors of a company shall not make use of their affiliation relationship to harm the interest of the company.

Under Article 147 of *Company Law*, the supervisors shall not take any bribe or another illegal gain by taking advantage of his position or misappropriate company assets for personal use.

Apart from the statutory obligations aforementioned, the shareholder can specify other obligations of the supervisors in the LLCs' Articles of Association according to their requirement of the supervisors, by means of which the shareholders can make the best use of the remedies as provided by *Company Law*. This specifically includes the ability of a shareholder to bring lawsuit against a supervisor in violation of his duties, which causes the company to suffer loss. The shareholder is entitled to request the Board of Directors or Executive Director of the LLCs to file the lawsuit against the relevant supervisor. Where the Board of Directors or

Executive Director refuses to or fails to file a lawsuit within 30 days of receiving the written request the shareholder is entitled to file a lawsuit in his own name.

7.4 Board of Supervisors

The following will illustrate the LLCs' Board of Supervisors in respect of its position, composition, the power of function, deliberation method and voting procedure.

A. **Position and Component**

In terms of the position, based on its power and function, the LLCs' Board of Supervisors should be an organ for the interest of the shareholders and companies to supervise the acts of the directors and senior management personnel.

In terms of the component, under Article 51 of *Company Law*, the LLCs' Board of Supervisors shall consist of at least three members, among others, the Board shall appoint a president, what's also worth mentioning is the term of the supervisors, under Article 52 of *Company Law*, the term of each supervisor shall not exceed 3 years. When the term of office expires, a supervisor may be reappointed or reelected and therefore serve consecutive terms. Furthermore, if no re-appointment or re-election is carried out upon the expiration of the term of office or a supervisor resigns during his term of office, resulting in the number of members of the Board of Supervisors being lower than the statutory number, the original supervisor shall continue to perform his duties in accordance with laws, administrative regulations and the articles of association of the company until a newly appointed or elected supervisor takes office.

B. **Power and Function**

Under Article 53 of *Company Law*, the LLCs' Board of Supervisor shall exercise the following power and functions: (1) inspect the financial affairs of the company; (2) supervise performance of the directors and senior officers of their respective company duties and propose the removal of any director or senior officer who violates any law, administrative regulation, the articles of association or any resolution of the board of shareholders; (3) require any director or senior officer to take corrective action where his actions damage the interests of the company; (4) propose the holding of interim meetings of the board of shareholders and convene and preside over meetings of the board of shareholders where the board of directors does not exercise its duties in this regard as prescribed in the Law; (5) put forward proposals at meetings of the board of shareholders; (6) file the lawsuits against a director or senior officer in accordance with Article 151 of *Company Law*; and (7) any other function or power specified in the articles of association.

Furthermore, under Article 54 of *Company Law*, the LLCs' supervisors may attend meetings of the Board of Directors as non-voting attendees, and may raise

questions or put forward suggestions about matters to be decided by the Board of Directors. The Board of Supervisors or, where there is no Board of Supervisors, the supervisors of a company find that the company is running abnormally, they may commence an investigation. Where necessary, they may, at the company's expense, hire an accounting firm to assist with the investigation.

C. **Deliberation method and Voting Procedure**

Under Article 55 of *Company Law*, it is mandatory for the Board of Supervisors to hold at least one meeting a year, with any supervisor possessing the ability to propose an interim meeting. Furthermore, it is mandatory that a resolution of the Board of supervisors shall be passed by a majority of supervisors.

In common with the Board of Shareholders and Board of Directors, apart from the mandatory deliberation method and voting procedure, the shareholders can specify the Board of Supervisor's deliberation method of voting procedure in the LLCs' Articles of Association.

7.5 Summary

As a summary, the Board of Supervisors plays an irreplaceable role in the LLCs' corporation governance, in order to equip the company with professional and efficient supervisors, the shareholders should be cautious about the candidates for the position of supervisor. Further, the shareholders must also take great consideration when designing and establishing of the Articles of Association, particularly in relation to the quorum required to convene the Supervisors Meeting, the Board of Supervisors' other powers and function beyond the statutory ones and the effective creation of the Board of Supervisors' resolution. Furthermore, given that the Board of Supervisors is under the obligation to prepare minutes of the adopted decision and the directors present at the meeting under the obligation to sign the minutes, the shareholders can exercise its statutory right to check the supervisors' decision or Board of Supervisor's resolution and determine whether the supervisors or Board of Supervisors are properly performing their duties.

Chapter 8
General Manager

8.1 Overview

Under *Company Law*, the position of manager is not mandatory for the LLCs, however, in practice, it is common for the LLCs to set the position of general manager practically handling the LLCs' daily management and business operation. The General Manager, as a one of the senior management personnel, should be properly governed as well in order to make the company achieve a sustainable and profitable business development.

8.2 Qualification of General Manager

According to Article 146 of *Company Law*, a person shall not serve as the General Manager: (1) a person with no or limited capacity for civil acts; (2) a person that was sentenced to criminal punishment for the crime of corruption, bribery, encroachment of property, misappropriation of property or disruption of the order of the socialist market economy, and not more than five years has elapsed since the expiration of the enforcement period; or a person that was deprived of his political rights for committing a crime, and not more than five years has elapsed since the expiration of the enforcement period; (3) a director, factory director or manager of a company or enterprise liquidated upon bankruptcy that was personally responsible for the bankruptcy of the company or enterprise, and not more than three years has elapsed since the date of completion of the bankruptcy liquidation; (4) the legal representative of a company or enterprise that had its business license revoked and had been closed down by order for violation of law, for which such representative bears individual liability, and not more than three years has elapsed since the date on which the business license of the company or enterprise was revoked; and (5) a person with a comparatively large amount of personal debts due and unsettled. If a

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G. Pisacane, *Corporate Governance in China*, China Law,
Tax & Accounting, DOI 10.1007/978-981-10-3911-9_8

company employs the General Manager against *Company Law*, such employment shall be invalid. If the General Manager falls under the circumstances as aforementioned during his term of office, the company shall dismiss him from his office.

Furthermore, as mentioned in Chap. 5, we also need to note that in respect of some industries particularly involving health and life or public interest or national security, the company's business license can be revoked due to activities which violate administrative regulations. If this is the case, its legal representative or a responsible person cannot serve any management position or even work in the same industry within a statutory period of time as of the day that the company receives the administrative punishment. This can extend to a lifetime bar on managerial or executive practice.

In terms of the creation of the General Manager, according to Article 49 of *Company Law*, the General Manager shall be engaged by the Board of Directors or Executive Director.

In common with the filing and recordation of the directors and supervisors, the name and any change of General Manager shall be filed and recorded with the competent company registration authority, otherwise, the authority has discretion to impose fine on the company.

8.3 General Manager's Obligations

According to *Company Law*, the LLCs' General Manager's obligations can be classified into those subject to the general requirement and those regarding the forbidden actions as well.

A. **General Requirement on Obligation**

According to Article 147 of *Company Law*, the General Manager of a company shall comply with laws, administrative regulations, and the Articles of Association and shall owe duties of fidelity and due diligence to the company.

According to Article 150 of *Company Law*, where the Board of Shareholders requires the General Manager to attend the meeting as a non-voting attendee, he shall do so and shall answer the shareholders' inquiries. The General Manager shall faithfully provide relevant information and materials to the Board of Supervisors or to the supervisor(s), and may not obstruct the Board of Supervisors or any supervisor in the exercise of its or his power and function.

Furthermore, according to Article 49 of *Company Law*, the General Manager shall attend meetings of the Board of Directors as a non-voting attendee.

B. **Obligation regarding Forbidden Actions**

According to Article 21 of *Company Law*, the General Manager shall not make use of their affiliation relationship to harm the interest of the company.

According to Article 147 of *Company Law*, the General Manager shall not take any bribe or another illegal gain by taking advantage of his position or misappropriate company assets for personal use.

According to Article 148 of *Company Law*, the General Manager shall not commit any of the following actions: (1) to misappropriate the company's funds; (2) to deposit the company's funds into an account under his own name or any other individual's name; (3) Without the consent of the shareholders' meeting, shareholders' assembly, or the board of directors, to loan the company's funds to others or to provide any guaranty to any other person by using the company's property in violation of the articles of association; (4) To enter a contract or to trade with the company infringing the articles of association or without the consent of the shareholders' meeting or the shareholders' assembly; (5) Without the consent of the shareholders' meeting or the shareholders' assembly, to seek for himself or any other person's business opportunities that belong to the company by taking advantages of his powers, or to operate for himself or for any other persons a business similar to that of the company for which he works; (6) to take for himself commissions on the transactions between others and the company; (7) Illegally disclosing the company's confidential information; (8) other acts inconsistent with the obligation of fidelity to the company.

Apart from the statutory obligations aforementioned, the shareholder can specify other obligations of the General Manager in the LLCs' Articles of Association according to their requirement on the General Manager, by means of which the shareholders can make the best use of the remedies as provided by *Company Law*. Most importantly, in the event that the General Manager contravenes his obligations (legal, administrative regulatory or conferred by Articles of Association) and this contravention leads to the company suffering a loss, all shareholders are entitled to request that the Board of Supervisors or supervisor(s) of the LLCs file a lawsuit against the General Manager. As expressed previously, a shareholder has the right to commence a lawsuit against the General Manager where the Board of Supervisors or supervisor(s) refuses to file a lawsuit or fails to file a suit within 30 days of receiving a written request from the shareholder.

8.4 General Manager's Power and Function

According to Article 49 of *Company Law*, the LLCs' General Manager shall be responsible to the Board of Directors and shall exercise the following functions and powers: (1) oversee the production and business operations of the company and organize the implementation of the resolutions of the board of directors; (2) organize the implementation of the company's annual operational plans and investment plans; (3) draw up plans for the establishment of the company's internal management departments; (4) draw up the company's basic management system; (5) formulate the company's specific rules and regulations; (6) propose the appointment or dismissal of the company's any deputy manager and financial principal; (7) decide

on the appointment or dismissal of executive personnel other than those whose appointment or dismissal is to be decided by the board of directors; and (8) any other function or power conferred on the manager by the board of directors. Where the functions and powers of the manager are otherwise provided in the Articles of Association, the Articles of Association shall prevail.

8.5 Summary

As a summary, given the General Manager is normally the individual who directly manages the employees and the business of the LLCs, the Board of Directors or Executive Director should sufficiently scrutinize the candidates for the position of general manager. For the interest of the shareholders and LLCs, the Board of Directors or Executive Director can establish and apply the General Manager Conduct Code as one of the LLCs' fundamental management system to regulate the acts of the General Manager, on the ground of which the company can terminate the labor contract with and claim damage against the General Manager where he disobeys and causes damage to the company.

Chapter 9
Corporate Governance Deadlock

9.1 Overview

As with any relationship, corporate relationships are subject to disagreements and the opportunity for parties to the agreements to become non-cooperative. Here, we will focus on the deadlock issues within Wholly Foreign-Owned Enterprise ("WFOE") and Joint Ventures (equity joint ventures ("EJV") and cooperative joint ventures ("CJV")), our attention will turn to what a deadlock is, what causes the deadlock and how investors can structure their agreements to avoid and solve deadlocks.

It is easy to see why foreign companies would want to enter a cooperative relationship with local Chinese companies. From gaining political connections to taking advantage of domestic knowledge, pre-built infrastructures and market share. Yet, managing a JV located in China is a path fraught with many challenges. One such challenge is the deadlock, essentially preventing the company from moving forward. A conflict between partners is anathema to a profitable business.

Firstly, it is worth noting the differences between the three business structures identified. A WFOE is a legal entity, which is 100% owned by one or more individual or corporate foreign investor(s). An JV, is a legal entity, invested in by foreign and domestic investors. The parties agree to create an entity by both contributing equity, and they then share in the revenues, expenses, and control of the enterprise.

9.2 What is Deadlock?

A company can be thought of as possessing its own will that is subject to the will of the shareholders (or directors in a JV), an observed 'dual-layer will.' Any dysfunction of will at either level will create a deadlock. Thus, a deadlock is a cessation

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G. Pisacane, *Corporate Governance in China*, China Law, Tax & Accounting, DOI 10.1007/978-981-10-3911-9_9

in corporate operational effectiveness or the loss of capacity to act, frustrating the purpose of the shareholders. In other words, a disagreement or lack of communication between company organs that are in charge of its functions, prevents the company from continuing its business effectively.

A. **What causes a deadlock?**

Simply put, company deadlock is where one entity decides to act opportunistically, resulting in the other partner(s) or shareholders retaliating defensively, by refusing to cooperate. Since the Board of Shareholders is the highest authoritative organ in a company as per PRC law for WFOEs and the board of directors for the JV, deadlock is often more common where the equity ratio or investment proportion between parties is too centralised, such as 50:50, 45:45:10 or 65:35 etc. particularly in instances which are required by law to have a two-thirds majority or a unanimous vote. Furthermore, deadlocks present a unique problem where there are two larger parties with a minority shareholder (45:45:10 for example) and each majority shareholder hopes to rally the minority. As a result, this can lead to a minority controlling the board.

Deadlocks cause more than a stoppage in company productivity, if they escalate to termination, deadlocks can disrupt shareholder strategies as well as plainly destroy value. The normal operation of a company is attained through shareholders' exercising their rights and through the resolutions of Directors. By becoming deadlocked, such decision-making processes become antagonistic and contentious. Even where meetings can be held, neither side wants to come to an agreement as a result of mutual opposition. Simply, this can damage company interests, cause stagnation in business and potential affect external relations, all of which impact the company's ability to function and remain profitable.

What's more, the deadlock ultimately affects the investors. A deadlock caused either by a lock in shareholder meetings or director meetings diminishes the opportunity for shareholders (investors in WFOEs) to exercise their rights. Where the deadlock causes a cessation of corporate activity, it could threaten the life of the company, particularly if it cannot react to crises in a timely manner.

The issue of deadlocks received Government attention in the 2005 amendment to Company Law (Chapter X in Company Law (Revised 2013)), providing that shareholders can apply to the People's Court for the dissolution of a company where such a company suffers serious difficulty in operation or management. Whilst this is a step in the right direction (mimicking Just and Equitable Winding-up in the UK), by instigating a judicial remedy for the deadlock, the provision itself is vague and undefined, requiring a judge to intricately examine the situation and decide. This, consequently, can lead to uncertainty, particularly as different courts of varying levels are increasingly aware of different concepts by which to judge the case on, leading to different verdicts were the same cases are decided differently. Moreover, this method is rather destructive, completely wiping the company from existence.

To this end, what can shareholders and partners draft into their agreements to ensure that deadlocks can be solved without obliterating the company?

9.3 Solutions

A key component in understanding when a deadlock has occurred is to define and demarcate the situation within an Article of Association or within the JV agreement. Furthermore, the provision should also define when a deadlock has been deemed to occur, such as when a member of the board fails to attend a meeting three consecutive times. By having a set of clearly defined situations, shareholders can act accordingly and thus proceed to either mediation or termination. This feeds into the general theme that Foreign Investors should seek to have a clear agreement.

Furthermore, in regards to JVs, whilst partners to the JV would be required to enter into an Equity Joint Venture agreement if the business is inside the negative list, the JVs can still face deadlock around the governing of the company. Thus no matter where the business is located, in a negative industry or not, it is better to have the contract thoroughly outline obligations and rights alongside pre-empting deadlocks. Whilst the agreement need only cover the legal minimums to set up the JV, it is advised to cover particulars as well.

A. **Preventative measures**

To truly have a strong contract, one must ensure that it contains three things: Clarity, compliance with obligations and the threat of litigation.

Often, Chinese companies will simply agree to everything and seek to blame a poor translation should anything run awry. To avoid this situation, the contract should be simple and use both English and Chinese. By having a simple contract, both parties can understand their obligations. Additionally, a contract that clearly outlines the obligations of both parties, with the clearly underlined penalties for a breach of these duties, will place the Foreign party in a strong position. Lastly, as with any matter, using litigation to leverage one's negotiation power places said party in a much stronger position and Chinese parties are no different.

The most basic preventative measure is to ensure that the equity split within WFOEs and EJVs is incapable of creating a deadlock. The situations mentioned above serve as a testament to this fact, thus rather than an equal 50:50, a 51:49 or even a 70:30 is more preferable. Further, the JV agreement or WFOEs' Articles of Association could confer different voting power which is unattributed to the equity ratio, in certain circumstances, such as conferring an effective 'double' vote on certain topics. As can be seen, a 100% solely-owned WFOE would avoid much of the deadlock created by splits in equity, as the single shareholder controls the unanimous vote.

A simple, yet effective, preventative measure is to provide for the Chairperson of a board to have a controlling vote in situations where a deadlock may arise. This is

especially useful for minor issues such as day-to-day problems but the provision may not be adequately equipped to deal with larger and more important decisions.

Upon the same vein, granting one partner with the sole decision making power over a particular category or subject matter decision can alleviate some potential for deadlock, particularly in a CJV, where power can be distributed without regard to contribution. Some provisions may designate sole authority over certain decisions, such as relating to working capital loans. Through providing for unilateral authority on such matters, the agreement seeks to avoid contentious issues that may arise and thus lead to deadlock. However, the effectiveness of such a provision can be questioned, as it is unlikely that either side is going to agree to the conferral of sole authority to one party, matters which substantively affect the company. Due to this, the provision's aim to avoid disputes may solely be limited to smaller, day-to-day issues, much like the Chairperson vote, above.

Moreover, deadlocks can also be caused by the abuse of veto rights and thus provisions regulating the internal use of such rights is needed. Since the matters are often technically detailed, so too must the provisions be, meaning that parties need to carefully craft an agreement which is tailored to the idiosyncrasy of the company.

Additionally, JV partners can resort to hosting a Partner Committee meeting. This a further resolution mechanism that enables the true parties to the dispute, to negotiate openly and attempt to reach an amicable solution, internally. This can often save time, cost and the need for intermediates to interact, as perhaps, the issue may not be only rational, but also emotional as well as the partners can be invested in the company, financially and personally.

B. Mediation Methods

However, should the preventative measures fail to stifle the deadlock in its embryonic stage, the partners to the JV or the shareholders of a WFOE may want to proceed to mediation.

Partners should make provisions to outline the procedure for proceeding to Conciliation and consultation—including arbitration. Where either board cannot reach a consensus on matters, mutual conciliation should be attempted. By attempting to solve the dispute amicably, the interests of the company can be put first and negotiations can help to understand the reasons for the deadlock, enabling both sides to gain a better understanding of the conflict.

For a JV, where such a deadlock cannot be broken through conciliation, the Chinese law on Sino-foreign Equity JV (Revised in 2016), accompanied by its implementation rule, dictates under Article 16, that the dispute must pass to mediation or arbitration as a means of resolving the dispute. In these instances, the parties should stipulate the exact name of the arbitration commission, venue and language for arbitration. In order to be effective, investors will want to consider naming a Chinese arbitration body as the governing authority. Should a party find itself on the weaker side, there are no preventative measures against transferring property ahead of time. Thus, an arbitration conducted abroad would provide no remedy in this instance. Yet, under Chinese law, should the engaging party show

that there is a real threat the arbitral award may be unenforceable, the Chinese court can preserve the property.

What's more, the JV laws of China stipulate that Chinese law has sole jurisdiction. Consequently, this can cause issues with enforcement of decisions from foreign courts. A further issue concerns the arbitral award, in that it may not be what either party had expected. Whilst the arbitrators will actively attempt to solve the deadlock issue, often the factors that result in deadlock are underpinned by technical financial or corporate issues.

C. Termination Methods

Lastly, a clear method of resolving the deadlock is to remove the other side from the equation, i.e. buying out their equity. Foreign legal practice has devised a 'Russian-Roulette' mechanism of resolving the dispute; that is, either party is entitled to buy-out the other. A further, 'Texas-Shootout' mechanism uses such a buy-out mechanic, but does so using sealed bids, removing the ability of the majority shareholder to abuse the information asymmetry of the minority shareholders who may not know the true financial health of the company.

A common practice is for the foreign party to exercise a 'put-option,' often included in contracts as standard. A put-option is exercised when certain circumstances that are stipulated in the provision are met, such as a deadlock, and when exercised, it requires the other side (normally the Chinese party) to purchase the party's equity interest in a JV. As a result, it may be necessary to ensure that the JV contract stipulates that each party ensures its board representative votes in favour of the equity transfer, and should specify the basic terms of the put option, such as price and method of valuing the equity share.

Yet, whilst put-options are often drafted into an agreement to avoid deadlocks, it is commonplace for parties to negotiate an exit, rather than going to court to enforce the option simply because it may be easier to maintain amicable relations through negotiation. Whilst this may be the case, having a put-option as a weapon for negotiation with the JV partner can help strengthening one's position. On the other hand, the foreign party may want to buy-out the Chinese party—turning the JV into a WFOE. Thus, this measure will only be possible in approved industries.

However, a deadlock provision is only effective in so far as it can solve a deadlock. One must consider the effect of removing a shareholder, (who may well be a director and thus have valuable business experience) from the equation. If the delay in decision making is not as damaging as losing an experienced adviser, the partners to the JV must consider their position carefully.

Furthermore, the partner may want to make a third-party transfer of equity. In some instances, one of the parties invested in the JV may want to transfer their equity to a third-party, thus exiting the venture themselves. Yet, the company laws require the consent of a majority of the other shareholders (Article 71 Revised in 2013) and thus, this can create difficulty since the company cannot agree on resolutions. However, the provision continues that, 'Where a majority of the other shareholders whose consent is sought disagree with the proposed transfer, the

shareholders who disagree with the proposed transfer shall purchase the stock rights to be transferred. In the event that they refuse to purchase the stock rights in question, they shall be deemed to have consented to the transfer.' This means that, either the dissenting shareholders purchase the equity or they will be deemed to have consented to the transfer to the third party.

The People's Court has, however, offered interpretative guidance to avoid this conclusion. The Interpretations of the Supreme People's Court on Several Issues Concerning the Trial of Disputes Involving Foreign-Invested Enterprises ("Interpretations"), as of 16 August 2010, provides it would uphold the equity transfer if:

1. There is evidence proving that the other shareholders have granted their consents;
2. The transferor has made a written notice regarding the equity transfer, but the other shareholders fail to give a reply within 30 days; or
3. The other shareholders do not agree to the transfer but refuse to purchase the equity from the transferring shareholder.

These regulations can be advantageous to the foreign party wishing to transfer its equity to a third party, but may be disadvantageous to them where the Chinese party wishes to transfer its interests to a third party who is a competitor, or one that has not been proven to be reliable. To minimize this risk, the parties should stipulate clearly the conditions for equity transfer in the JV contract, such as forbidding equity transfer to certain competitors.

The most powerful of the provisions for deadlock resolution is the most destructive. A Deadlock Provision allows a party to unilaterally initiate the procedure set out under the provision, whether that triggers a buy-out, arbitration or the dissolution of the company. The provision should clearly outline, identify and demarcate the grounds and various situations that a party can initiate the deadlock provision. Commonly, deadlock provisions enable the aggrieved party to initiate the dissolution of the JV. Should the partners to the JV fail to instigate an equity transfer (either voluntarily or involuntarily), the logical next step is to seek the dissolution of the company and completely wash away any liability.

Article 90 of Implementing Regulations of the Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures (Revised in 2014) lays out the circumstances in which this can be achieved, including suffering heavy losses which result in the inability to operate, breach of contract causing an inability to operate and a conflict has arisen between the original purpose of the company and its ability to develop further. In addition, Article 33 requires a unanimous vote in order to initiate the dissolution, in the absence of a deadlock provision to the contrary.

Should a company not fulfil any of the criteria in Article 90, Article 180 of the Company Law provides an alternative method for the foreign shareholder to force or threaten dissolution of the JV (including WFOEs), "Where a company has serious difficulty in its operation and management and its continuance would cause material losses to the interests of the shareholders, and such difficulties cannot be

resolved through other means, shareholders who hold 10% or more of all the voting rights of the company may request the people's court to dissolve the company."

The threat of litigation and the ensuing dissolution can encourage the Chinese party to negotiate the termination of the JV relationship.

9.4 Summary

To note, Chinese legislation subscribes the governance of Sino-foreign joint venture contracts to the exclusive jurisdiction of Chinese law. Withal, having preventative measures in place when one enters into a JV can help ensure the protection of their interests. As with all relationships, joint ventures are prone to disagreements and thus, having protection in place to prevent deadlocks can smooth out corporate activity and keep the wheels turning. This chapter focused on ways partners can avoid and solve deadlocks created by disagreements between parties.

Chapter 10
Annual Compliance: Annual Reports and Approval of Financial Statements

In addition to the internal corporate governance structuring system, governmental compliance is another important aspect of the system.

Under Article 163 of *Company Law*, "*Companies shall establish their financial and accounting systems in accordance with laws, administrative regulations, and the regulations of the finance department of the State Council*".

The respect of this rule by FIEs is constantly checked by the authorities by means of a number of compliance processes that must be undertaken periodically, such as annual reports and other declaration obligations, collectively referred to as "annual compliance".

10.1 Audit Report

Every FIE must periodically entrust a Chinese CPA firm to certify the respect of Chinese accounting principles and Chinese standards in the drafting of its financial statements (paragraph 1 of Article 164 of *Company Law*). The verification process carried out by the auditor is called a "financial audit" and generally lasts around two months.

The auditor drafts an audit report certifying that the bookkeeping and the data filed monthly with the local authorities are truthful, reliable and correctly registered. Furthermore, the audit report carries out any adjustments necessary in the calculation of taxable corporate income.

The structure of the audit report is partially variable depending on the province. Generally, it must be filed with the competent administration within the end of April of each year. The audit report must be signed by a person having the qualification of Certified Public Accountant (CPA).

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G. Pisacane, *Corporate Governance in China*, China Law, Tax & Accounting, DOI 10.1007/978-981-10-3911-9_10

10.2 Tax Compliance

From March 1st until June 30th each year, all FIEs must undergo the so-called "tax compliance". This is an annual inspection in which an enterprise provides the tax authorities with documents regarding the nature and the volume of business transactions carried out during the preceding year.

Any FIEs that do not complete their tax compliance procedures within the term, may be subject to sanctions, including insertion in an ad hoc "black list" and, in many cases, the payment of a sanction that may reach RMB 100,000.00.

10.3 Annual Inspection

The annual audit and the tax reconciliation are followed by the annual inspection. Such inspection is carried out jointly by a number of administrative authorities between March and June of every year. The main administrations involved are Ministry of Commerce, Ministry of Finances, State Administration of Industry and Commerce, State Administration of Taxation, State Administration of Foreign Exchange and National Bureau of Statistics of China.

Essentially, the annual inspection must ascertain that a FIE operates in compliance with Chinese laws and regulations.

10.4 Approval of the Financial Statements by the Board of Shareholders

The company bookkeeping check, performed by the board of shareholders, is regulated by Chapter VIII of the Company law. Under Article 165 of *Company Law*, "*A limited liability company shall deliver its financial and accounting reports to each of the shareholders within the time limit specified in its articles of association.*

The financial and accounting reports of a company limited by shares shall be made available at the company for the perusal of shareholders twenty days before the annual general meeting is held.[…]".

Therefore, the audit report of a limited liability company (see above) must be yearly submitted to the board of shareholders only if the articles of association expressly so stipulate; however, there is no general legal obligation to do so.

Article 166 of *Company Law* establishes some limitations regarding the distribution of profits. The company, be it a limited liability company or a joint stock company, must allocate 10% of its yearly net profit as a mandatory reserve in order to cover any losses in subsequent financial years. Allocating a part of the profits to a mandatory reserve will no longer be mandatory when the mandatory reserve has

reached 50% of the registered capital of the company. Losses can be postponed up to five years. Apart from said mandatory reserve, the shareholders may decide to constitute a second reserve.

After the amounts to be allocated as a mandatory reserve have been deducted, the remaining part of net profits can be distributed to the shareholders.

Chapter 11
Company Seals

Company seals, or more commonly known as company chops, have a fundamental role in the administration of the company. The *chop* represents the company's will and has a "signature" function; it is often accompanied by the signature of the legal representative or other individuals having management functions. Every company must have a main seal, called the *company chop*, (or *company official seal*, *company official chop, or general corporate seal*) and a seal for financial operations, called *financial chop*; other chops will be adopted if necessary, based on the activities of the company.

A. **Company Chop**

The *company chop* is the most important seal for the company. It has the function of "signature" of the company as a legal person: the application of the *company chop*, unless fraud is proved, *binds the company under the law.*

This function of the company chop is not set forth by any specific written rule, but has strong roots in common practice; therefore, the use of chops is required by a number of important civil and commercial laws. Article 65 of the PRC General Principles of Civil Law requires the signature *or the chop* of the principal in a power of attorney[1]; under Article 32 of the PRC Contract Law, a contract is deemed to have been stipulated when the signature or the *chop* of the parties is applied.[2] Therefore, where a party to the contract is a company and not a natural person, a contract will have to be sealed and not merely signed.

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[1]Article 65 paragraph 2 of the PRC General Principles of Civil Law: "*Where the entrustment of agency is made in writing, the power of attorney shall clearly state the agent's name, the entrusted tasks, the scope and duration of the power of agency, and it shall be signed or sealed by the principal*".

[2]Article 32 of the PRC Contract Law: "*Where the parties enter into a contract in written form, the contract is stipulated when it is signed or sealed by the parties*".

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G. Pisacane, *Corporate Governance in China*, China Law,
Tax & Accounting, DOI 10.1007/978-981-10-3911-9_11

The Company Law itself requires the *chopping* of several documents, among which the certifications of capital contribution,[3] share certificates[4] and bond certificates[5]; the *company chop* is generally required in applications, registrations and reports submitted to administrative authorities.

The company seal must be used with red ink and is registered with the Public Security Bureau in the place where the company has its registered headquarters.

The *company cho*p is normally kept by the companies' legal representative who normally serves the position of general manager.

B. **Legal Representative Chop**

In many cases, the law requires, in order for the company to be legally bound, the signature of the legal representative, together with the company chop or without it. It is a common—though not mandatory—practice to carve a *legal representative chop*, to be kept at the company headquarters, in order to be able to execute documents in the name of the legal representative even when they are not physically present.

C. **Contract Chop**

A company may choose to adopt a *contract chop* for the execution of contracts. Generally, smaller companies and those whose operations are not complex do not adopt a *contract chop.*

D. **Finance Chop**

The *finance chop* is used for the company's financial transactions of the: opening and operating bank accounts, cash withdrawals, bank transfers, etc. In many companies, this seal is also used for issuing invoices, replacing the invoice chop (see in the following). The *finance chop* is usually kept by the head of the department that engages in financial transactions.

E. **Invoice Chop**

The invoice chop is used to issue *fapiao* (发票), invoices that have both the function of registering a transaction and of documenting it for tax purposes: without the seal of the company, an invoice will not be valid. The *invoice chop* has an oval shape and is printed in red; it may be substituted by the *finance chop*.

[3]Paragraph 3 of Article 31 *of Company Law*: "*The certificate of capital contribution must be stamped with the seal of the company*".

[4]Paragraph 3 of Article 128 *of Company Law*: "*Share certificates must be signed by the legal representative and stamped with the seal of the company*".

[5]Article 155 *of Company Law*: "*When a company issues bonds* […] *the bonds must be signed by the legal representative and stamped with the seal of the company*".

F. **Human Resources Chop**

If adopted, the Human Resources Chop is used to stipulate labor contracts, seal documents for public administrations regarding employees, execute internal communications related to human resources etc.

Given that the sealing of a document binds the company, the Chinese seal system presents remarkable risks. In particular, a seal may be used by unauthorized individuals, or be used ultra vires and beyond their powers by authorized individuals. Furthermore, it may happen that the individual in charge of keeping and using a seal refuses to give it back. In this respect it useful to specify that in China the limits to the powers of company representatives cannot be known as easily as in many Western systems as often they are not published.

A number of measures may be put in place to prevent the abuse of seals or at least to minimize its consequences. First of all, it is advisable to set up precise procedures for the use of each seal, whereby each seal may only be used with the prior written approval of the individual in charge of keeping it; it is a good practice to keep a register of the instances of use of each seal, together with copies of the documents that have been *chopped* with it; the seals should only be used at the premises of the company and only in working hours, to be then always kept in a safe at the company's premises outside of working hours.

Moreover, it is necessary to define with precision in the articles of association and/or in the letter of appointment of the legal representative and of the general manager the operations that such individual may carry out autonomously, i.e., without prior approval of the board of shareholders or of the board of directors. Where this kind of precaution has been adopted, the company, although it may not invoke the limits of the powers of its legal representative or general manager against third parties, will, however, have solid legal grounds in a legal action for damages against such legal representative or general manager that used the chops ultra vires.

The theft and the loss of a company seal have to be reported to the Public Security Bureau. The worst cases are those in which the seal is stolen by the very person who is in charge of keeping it. In these cases it is possible both to act with the competent administrative authorities (i.e., the Public Security Bureau) and to commence legal proceedings with the People's Courts; this second action is based on Article 147 of *Company Law*[6] and on Article 91 of the *Meeting Minutes of the Second National Forum on Foreign-Related, Commercial and Maritime Trials* (2005), according to the latter, "*the People's Courts accept petitions by foreign invested enterprises requesting to recover a company seal from a natural person, for a legal person or from another entity*".

[6]Article 147 of *Company Law*: "*The directors, the supervisors, and the other high officers shall act in accordance with the law, administrative regulations and the articles of association of the company and have a fiduciary duty and a duty of care towards the company.*

The directors, supervisors and high officers may not take advantage of their positions and their powers to collect or accept bribes or other illegal income, and shall not harm the property rights of the company".

Both the action before the Public Security Bureau and the legal proceedings before the People's Courts prove quite difficult, especially when the *company chop* or the *legal representative chop* are involved. The Public Security Bureau will require a new seal to be issued upon the request of the legal representative indicated in the business license of the company, who may be the very person responsible for the seals' subtraction. In order for the seal to be classified as "stolen" and thus enable an authority to request new seals to be carved, the company is required to dismiss the legal representative responsible for the theft and register a new representative with the competent Administration for Industry and Commerce. Similarly, in order to proceed with a claim before the People's Courts, the documents necessary to file the petition to retrieve the seal will have to be stamped with the *company chop*, or, lacking the *company chop*, with the signature or the seal of the legal representative.

Moreover, the remedy offered by the Public Security Bureau and by the People's Court is often not expedient. In the case *Guangxi Paida*, decided in 2011 by the No. 1 Intermediate People's Court of Beijing, the court held the resolution with which the board of shareholders dismissed the general manager to be valid and effective; it acknowledged that the seals and the accounting books stolen by the general manager were the company's property and, given that he had been dismissed, he had no legal title to keep them. The judgment ordered the defendant to hand back the company's seals and the accounting books within ten days from the rendering of the judgment[7]; however, the judgment was rendered nearly two years after the facts of the case had occurred, thus proving an untimely remedy.

[7] *GuangxinPaida (Beijing) Environmental Protection Energy-Saving Technology Co., Ltd. v. Yan Wenshan*, [2009] Yi Zhong Min ZhongZi No. 17878.

Chapter 12
Particular Nuances of Corporate Governance: State-Owned Companies and Family-Owned Companies

In some types of Chinese companies, the relationship between owners and management of a company takes on nuances which may be unfamiliar for foreign observers.

We are referring, firstly, to wholly state-owned enterprises, originally the focus of the Chinese socialist economy, which dominated national economy until the 1980s. Many of them have now been turned into private enterprises; many of the contemporary largest Chinese companies are former SOEs.

An SOE, as conceived in the original socialist theory, did not have legal personality: it was not an entity that had its own rights and bore its own obligations, but rather was an "accumulation of assets". The property with which the SOE used to perform its activity, as well as any profits resulting therefrom, were owned by the State. The State-Owned Enterprises Law of 1988 made radical changes in these regards, stipulating that SOEs were to have legal personality and could be held accountable for their obligations (even though some years still had to pass before SOEs actually became the owners of all the assets they used for their activity).

The essential first step in the reform process started in the 80s, which led to cessation of state intervention in the management choices of these enterprises. SOEs had to be given the ability to make autonomous decisions and therefore had to be responsible for both their profits—of which they were authorized to keep a portion—and for their losses. Consequentially, the directors of SOEs gradually obtained more freedom in company management. The reform, however, was not aimed at changing the proprietorship of the companies, which kept being owned by the State, but rather to remedy the inefficiency of state management.

Although the above-illustrated reforms made during this period marked a success of the Chinese "open door" policy, they had the unintended effect of pushing managers of SOEs to take initiatives that maximized the profit of their enterprises in the short term, to the detriment of the healthy and balanced growth in the long run. Moreover, the policy resulted in a disproportioned growth of the debt of SOEs in relation to their capital; in the 90s, the huge debts of many of these companies would go so far as to threaten the very survival of the Chinese way to economic development.

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G. Pisacane, *Corporate Governance in China*, China Law, Tax & Accounting, DOI 10.1007/978-981-10-3911-9_12

For the first time, the 1993 Company Law regulated companies in general, regardless of their public or private ownership. However, although the Company Law applied to both SOEs and private enterprises, it was drafted having in mind the former, which at the dawn of the 90s were still the backbone of the national economy.

The new season of reforms inaugurated with the 1993 Company law marked a change of perspective if compared with the legal novelties of the 80s. The latter were aimed at making the administration of enterprises more autonomous from state bureaucracy, the reforms of the 90s were aimed at the so-called corporatization of SOEs, i.e., to increasing the ratio of private participation in those then exclusively state-owned companies. In this perspective, non-transferable shares were gradually assigned to company managers, pushing them to pay more attention to the healthy long-term development of the company.

To this day, both in SOEs and, although to a lesser degree, in many former SOEs, corporate governance issues tend to overlap with political priorities.

At the other end of the spectrum, in comparison with State-owned enterprises, are small family-owned companies. Theoretically illegal until the end of the 70s, family-owned enterprises developed in the chaotic and ever-changing economic environment and in the almost total lack of laws; therefore, in family-owned companies, it may be said that corporate governance rules are a subsequent addition to an already formed arrangement. It has been said that, given the low level of publicity of company information, of protection of proprietary rights and investment, many private enterprises have found a rather advantageous solution in family control.[1]

The proprietary and management arrangements thus created an escape, in some cases, from the provisions of the Company Law and the relevant administrative regulations. For example, family-owned companies escape the rules that refer to the concept of “controlling shareholder”, given that, for example, the controlling share may be assigned to several family members that will vote in the same way, even if not regulated explicitly.

Furthermore, as we have seen in the preceding chapters, since the reform of 2005 the Company Law has progressively imposed on shareholders, directors, high officers and supervisors a number of duties accompanied by the possibility to commence legal proceedings. In family-owned companies such rules tend to be applied scarcely and with fewer rigors, given that the involved persons have no interest—or less interest—in operating reciprocal controls.

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[1]Chen (2009).

Chapter 13
Company Law of the People's Republic of China (Revised in 2013)

(Adopted at the 5th Session of the Standing Committee of the 8th National People's Congress on December 29, 1993. Revised for the first time on December 25, 1999 in accordance with the Decision of the 13th Session of the Standing Committee of the Ninth People's Congress on Amending the Company Law of the People's Republic of China. Revised for the second time on August 28, 2004 in accordance with the Decision of the 11th Session of the Standing Committee of the 10th National People's Congress of the People's Republic of China on Amending the Company Law of the People's Republic of China. Revised at the 18th Session of the 10th National People's Congress of the People's Republic of China on October 27, 2005. Revised for the third time on December 28, 2012 in accordance with the Decision on Amending Seven Laws Including the Marine Environment Protection Law of the People's Republic of China at the 6th Session of the Standing Committee of the 12th National People's Congress. It is now promulgated and shall come into effect as of March 1, 2014.)

Standing Committee of the National People's Congress
December 28, 2013

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G. Pisacane, *Corporate Governance in China*, China Law, Tax & Accounting, DOI 10.1007/978-981-10-3911-9_13

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Chapter I: General Provisions

Article 1: The Company Law of the People's Republic of China (hereinafter referred to as the "Law") has been enacted in order to standardize the organization and activities of companies, protect the lawful rights and interests of companies, shareholders and creditors, safeguard the social and economic order and promote the development of the socialist market economy.

Article 2: For the purposes of the Law, the term "companies" refers to limited liability companies and companies limited by shares established within the territory of China pursuant to the Law.

Article 3: A company is an enterprise legal person, which has independent corporate property and enjoys corporate property rights. A company shall be liable for its debts to the extent of all of its property.
A shareholder of a limited liability company shall be liable for the company to the extent of the capital contribution it subscribes. A shareholder of a company limited by shares shall be liable for the company to the extent of the shares it subscribes.

Article 4: The shareholders of a company shall enjoy such rights as return on assets, participation in major decision-making and selection of managers according to the law.

Article 5: When engaging in business activities, a company shall abide by laws and administrative regulations, observe social morality and business ethics, act in good faith, accept supervision by the government and the public, and bear social responsibilities.
The lawful rights and interests of companies shall be protected by law and shall not be infringed upon.

Article 6: To establish a company, an application for registration of establishment shall be filed with the company registration authority according to the law. If the conditions of establishment specified herein are met, the applicant shall be registered by the company registration authority as a limited liability company or a company limited by shares. If the conditions for establishment specified herein are not met, it may not be registered as a limited liability company or a company limited by shares.
If laws or administrative regulations provide that the establishment of a company is subject to approval, approval procedures shall be carried out according to the law prior to the company's registration.
The public may apply to the company registration authority for inquiring the registered particulars of a company, and the company registration authority shall make such inquiry available.

Article 7: A company established according to the law shall be issued a company business license by the company registration authority. The date of issue of the company business license shall be that of the establishment of the company.
The company business license shall contain the name, address, registered capital, the scope of business and the name of the legal representative of the company.
In the event of any change to any item recorded in the company business license, the company shall carry out change registration formalities and a new business license shall be renewed by the company registration authority.

Article 8: The name of a limited liability company established in accordance with the Law shall contain the words "limited liability company" or "company limited". The name of a company limited by shares established in accordance with the Law shall contain the words "company limited by shares" or "joint stock company".

Article 9: If a limited liability company intends to be converted into a company limited by shares, the conditions with respect to companies limited by shares set forth herein shall be satisfied. If a company limited by shares intends to be converted into a limited liability company, the conditions with respect to limited liability companies set forth herein shall be met.
If a limited liability company is converted into a company limited by shares, or if a company limited by shares is converted into a limited liability company, the claims and debts of the company that have arisen prior to the conversion shall be succeeded to by the company after the conversion.

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

Article 11: To establish a company, the articles of association shall be formulated according to the law. A company's articles of association shall be binding upon the company, shareholders, directors, supervisors and senior officers.

Article 12: The scope of business of a company shall be specified in the articles of association of the company and shall be registered according to the law. A company

may amend its articles of association and change the scope of business, provided that it shall carry out change registration.
If any item in the scope of business of a company is subject to approval as required by laws or administrative regulations, such item shall be approved according to the law.

Article 13: The chairman of the board, the executive director or the manager of the company shall act as the legal representative of a company pursuant to the articles of association of the company and the same shall be registered according to the law. In the event of any change in the legal representative of the company, formalities shall be carried out for registration change.

Article 14: A company may establish branches. To establish a branch, an application shall be made to the company registration authority for registration and a business license shall be obtained. A branch does not have the status of a legal person and its civil liability shall be borne by the company.
A company may establish subsidiaries. A subsidiary has the status of a legal person and independently bears civil liability according to the law.

Article 15: A company may invest in other enterprises, provided that it may not become an investor that bears joint and several liability for the debts of the enterprise in which it invests, unless otherwise provided by law.

Article 16: If a company invests in another enterprise or provides security for another party, a resolution shall be adopted by the board of directors or by the board of shareholders or general meeting according to the provisions of the articles of association of the company. If the articles of association of the company have specified a limit on the total amount of investment or security and the amount of a single investment or security, the specified limit may not be exceeded.
If a company provides security for a shareholder or the de facto controller of the company, a resolution of the board of shareholders or general meeting shall be passed.
Any shareholder set forth in the preceding paragraph or controlled by a de facto controller set forth in the preceding paragraph may not participate in voting on any resolution specified in the preceding paragraph. Such resolution shall be adopted by the other shareholders that are present at the meeting and represent more than half of the voting rights.

Article 17: A company shall protect the lawful rights and interests of its employees, and enter into labor contracts with its employees, contribute social insurance premiums, strengthen labor protection and ensure production safety according to the law.
A company shall use various methods to strengthen the vocational education and on-the-job training of its employees in order to improve their capabilities.

Article 18: The employees of a company shall organize a labor union and conduct labor union activities in accordance with the Labor Union Law of the People's Republic of China to protect the lawful rights and interests of the employees. The

company shall provide its labor union with conditions necessary for conducting its activities. The labor union of the company shall enter into collective contracts on behalf of the employees with the company with respect to such matters as labor remuneration, working hours, welfare, insurance and labor safety and health of the employees according to the law.
A company shall implement democratic management through the employees' representative congress or other channels in accordance with the provisions of the Constitution and relevant laws.
When a company discusses and decides on restructuring and major issues concerning its business operation or formulates major rules, regulations and policies, it shall solicit opinions from the labor union of the company, as well as opinions and suggestions from its employees through the employees' representative congress or other channels.

Article 19: In a company, an organization of the Communist Party of China shall be established to carry out the activities of the party in accordance with the charter of the Communist Party of China. The company shall provide the necessary conditions for the activities of the party organization.

Article 20: The shareholders of a company shall abide by laws, administrative regulations and the articles of association of the company and exercise shareholder's rights according to the law, and may not abuse shareholder's rights to harm the interests of the company or other shareholders, or abuse the independent status of the company legal person and the limited liability of shareholders to harm the interests of the creditors of the company.
If a shareholder of the company abuses its shareholder's rights, thereby causing losses to the company or other shareholders, the shareholder shall be liable for compensation according to the law.
If a shareholder of the company abuses the independent status of the company legal person and the limited liability of shareholders to evade debts and seriously harms the interests of the creditors of the company, it shall bear joint and several liability for the debts of the company.

Article 21: The controlling shareholder, de facto controller, directors, supervisors and senior officers of a company may not use their affiliation to harm the interests of the company.
Anyone that violates the provisions of the preceding paragraph and causes losses to the company shall be liable for compensation.

Article 22: A resolution of the board of shareholders or general meeting or the board of directors of a company shall be void if its contents are in violation of laws or administrative regulations.
If the procedure for convening the board of shareholders or general meeting or the meeting of the board of directors, or the method of voting violates laws, administrative regulations or the articles of association of the company, or if the contents of a resolution violate the articles of association of the company, a shareholder may,

within 60 days of the adoption of the resolution, petition to a people's court for cancellation of resolution.
If the shareholder institutes proceedings pursuant to the preceding paragraph, the people's court may, at the request of the company, require the shareholder to provide a corresponding security.
If the company has carried out change registration in accordance with the resolution of the board of shareholders or general meeting or the board of directors, the company shall apply to the company registration authority for cancellation of the change registration after the people's court declares the resolution invalid or cancels the resolution.

Chapter II: Establishment and Organizational Structure of Limited Liability Companies

Section 1: Establishment

Article 23: The following conditions shall be fulfilled for the establishment of a limited liability company:

(I) the number of shareholders conforms to the statutory number;
(II) the capital contribution subscribed by subscribed by all shareholders is consistent with that prescribed in the articles of association;
(III) the shareholders have jointly formulated the company's articles of association;
(IV) the company has a name and an organizational structure established in conformity with the requirements for limited liability companies; and
(V) the company has a domicile.

Article 24: A limited liability company shall be invested in and established by no more than 50 shareholders.

Article 25: The articles of association of limited liability companies shall specify the following particulars:

(I) the name and domicile of the company;
(II) the business scope of the company;
(III) the registered capital of the company;
(IV) the names and domiciles of the shareholders;
(V) the method, amount and time of capital contribution by the shareholders;
(VI) the organization of the company and its methods of establishment, functions and powers, and rules of procedure;
(VII) the legal representative of the company; and
(VIII) other matters that the shareholders deem necessary to be specified.

Shareholders shall sign and affix their seals on the company's articles of association.

Article 26: The registered capital of a limited liability company shall be the capital contributions subscribed by all shareholders as registered with the company registration authority.
Where laws, administrative regulations and the decisions of the State Council stipulate the actual paid registered capital and another amount on the minimum registered capital of a limited liability company, such stipulations shall prevail.

Article 27: Shareholders may make capital contribution in currency or in non-currency property that may be valued in currency and transferable according to the law such as physical objects, intellectual property and land use rights, except for property that may not be used as capital contribution according to the laws or administrative regulations.
Non-currency property contributed as capital shall be valued and verified, and shall not be over-valued or under-valued. Where laws or administrative regulations have provisions on valuation, such provisions shall prevail.

Article 28: Each shareholder shall make the capital contribution it subscribes as specified in the articles of association of the company on time and in full. If a shareholder makes its capital contribution in currency, it shall deposit the full amount of capital contribution in currency in a bank account opened by the limited liability company with a bank. If capital contribution is made in non-currency property, the transfer procedures for the property rights therein shall be handled according to the law.
If a shareholder fails to make capital contribution in accordance with the preceding paragraph, it shall, in addition to making capital contribution in full to the company, be liable for breach of contract to the shareholders that have made their capital contributions on time and in full.

Article 29: After the shareholders subscribed the capital contribution in full as prescribed in the articles of association, a representative designated by all shareholders or an agent jointly appointed by them shall submit a company registration application and documents such as the company's articles of association to the company registration authority to apply for registration of establishment.

Article 30: If, after establishment of a limited liability company, the actual value of the non-currency property contributed as capital for the establishment of the company is found markedly lower than the value as set forth in the articles of association of the company, the shareholder making such contribution shall make up for the difference. The other shareholders as at the time of the company's establishment shall bear joint and several liability for such difference.

Article 31: A limited liability company shall issue capital contribution certificates to its shareholders after it is established.
The capital contribution certificate shall specify the following particulars:

(I) the name of the company;
(II) the date of establishment of the company;

(III) the registered capital of the company;
(IV) the name of the shareholder, the amount of its capital contribution made and the date of capital contribution; and
(V) the serial number and date of issuance of the capital contribution certificate.

The capital contribution certificate shall be affixed with the seal of the company.

Article 32: A limited liability company shall establish a register of shareholders to record the following items:

(I) the names and domiciles of the shareholders;
(II) the amounts of capital contribution of the shareholders; and
(III) the serial numbers of the capital verification certificates.

The shareholders on the register of shareholders may claim and exercise shareholder's rights on the basis of the register of shareholders.
The company shall register the names of its shareholders with the company registration authority. If there is a change in the registered items, change registration shall be carried out. Anyone that fails to complete registration or change registration may not resist the claims of a third person.

Article 33: Shareholders shall have the right to examine and reproduce the articles of association of the company, the minutes of the board of shareholders, the resolutions of the meetings of the board of directors, the resolutions of the meetings of the board of supervisors and the financial and accounting reports.
Shareholders may request to examine the account books of the company. If a shareholder requests to examine the account books of the company, it shall make a written request to the company stating the purpose thereof. If the company has reasonable basis to believe that the purpose of the examination of the account books by the shareholder is improper and that such examination may harm the lawful rights and interests of the company, the company may refuse to make the books for examination available, and shall reply to the shareholder in writing and state the reason for the refusal within 15 days of the written request of the shareholder. If the company refuses to provide the account books for examination, the shareholder may petition to the people's court for provision of the account books by the company.

Article 34: A shareholder shall receive dividends in proportion to its paid-up capital contribution. When the company increases its capital, the shareholder shall have the priority right to subscribe for capital contribution in proportion to its paid-up capital contribution, except where all shareholders agree not to receive dividends in proportion to the paid-up capital contribution or not to exercise priority right to subscribe for capital contribution in proportion to the paid-up capital contribution.

Article 35: After a company is established, its shareholders may not withdraw their capital contribution.

Section 2: Organizational Structure

Article 36: The board of shareholders of a limited liability company shall be composed of all the shareholders. The board of shareholders shall be the organ of authority of the company and shall exercise its functions and powers pursuant to the Law.

Article 37: The board of shareholders shall exercise the following functions and powers:

(I) to decide on the business policies and investment plans of the company;
(II) to elect and replace directors and supervisors that are not appointed from representatives of staff and workers, and to decide on matters concerning the remuneration of directors and supervisors;
(III) to consider and approve reports of the board of directors;
(IV) to consider and approve reports of the board of supervisors or supervisors;
(V) to consider and approve the company's proposed annual financial budgets and final accounts;
(VI) to consider and approve the company's profit distribution plans and plans for making up losses;
(VII) to pass resolutions on the increase or reduction of the company's registered capital;
(VIII) to pass resolutions on the issuance of corporate bonds;
(IX) to pass resolutions on matters such as the merger, division, dissolution, liquidation or change of the corporate form of the company;
(X) to amend the articles of association of the company; and
(XI) other functions and powers specified in the articles of association of the company.

If the shareholders unanimously express consent to the matters set out in the preceding paragraph in writing, the decision may be made, without convening of the board of shareholders, directly with a document of the decision bearing the signatures and seals of all shareholders.

Article 38: The first general meeting shall be convened and presided over by the shareholder that made the largest capital contribution, and shall exercise its functions and powers pursuant to the provisions hereof.

Article 39: General meetings shall be divided into regular meetings and extraordinary meetings.
Regular meetings shall be convened on time in accordance with the articles of association of the company. An extraordinary meeting shall be convened if it is proposed by shareholders representing one tenth or more of the voting rights, or by one third or more of the directors or the board of supervisors or, in the case of a company without a board of supervisors, the supervisor(s).

Article 40: If a limited liability company has established a board of directors, the general meeting shall be convened by the board of directors and presided over by the chairman of the board. If the chairman of the board is unable to or does not perform his duty, the meeting shall be presided over by the vice-chairman of the

board. If the vice-chairman of the board is unable to or does not perform his duty, the meeting shall be presided over by a director jointly designated by more than half of the directors.

If a limited liability company has no board of directors, the general meeting shall be convened and presided over by the executive director(s).

If the board of directors or the executive director(s) cannot or do not perform the duty of convening the general meeting, the meeting shall be convened and presided over by the board of supervisors or, in the case of a company without a board of supervisors, the supervisor(s). If the board of supervisors or the supervisors do not convene and preside over the meeting, the meeting may be convened and presided by the shareholders representing one-tenth or more of the voting rights.

Article 41: If a general meeting is to be convened, all shareholders shall be notified 15 days before the meeting is held, unless otherwise stipulated in the articles of association of the company or agreed by all shareholders.

The board of shareholders shall keep minutes of the decisions on the matters under its consideration. The shareholders present at the meeting shall sign the minutes of the meeting.

Article 42: Shareholders shall exercise voting rights at general meetings in proportion to their capital contribution, unless otherwise stipulated in the articles of association of the company.

Article 43: The method of deliberation and voting procedures of the board of shareholders shall be specified in the articles of association of the company, except where stipulated herein.

Resolutions of the general meeting on the amendment of the articles of association of the company, increase or reduction of the registered capital, and merger, division, dissolution or change of corporate form shall be adopted by shareholders representing two thirds or more of the voting rights.

Article 44: A limited liability company shall have a board of directors of three to 13 members, unless otherwise stipulated in Article 51 hereof.

In a limited liability company invested in and established by two or more State-owned enterprises or two or more other State-owned investment entities, the members of the board of directors shall include representatives of the staff and workers of the company. In other limited liability companies, the members of the board of directors may include representatives of the staff and workers of the company. Representatives of staff and workers on the board of directors shall be democratically elected by the staff and workers of the company through the staff and workers' congress, the staff and workers' general meeting or other ways.

A board of directors shall have one chairman of the board and may have vice-chairmen of the board. The method of appointment of the chairman and vice-chairman (or vice-chairmen) of the board shall be specified in the articles of association of the company.

Article 45: The term of office of directors shall be specified in the articles of association of the company but each term may not exceed three years. If re-elected upon expiration of his term of office, a director may serve consecutive terms.
If no new director is elected in time upon expiration of the term of office of a director, or if a director resigns during his term of office, resulting in the number of members of the board of directors falling below the statutory number, the original director shall perform his duties as director according to the provisions of laws, administrative regulations and the articles of association of the company before a newly elected director takes office.

Article 46: The board of directors shall be accountable to the board of shareholders, and shall exercise the following functions and powers:

(I) to convene the general meeting and to report on its work to the board of shareholders;
(II) to implement the resolutions of the general meeting;
(III) to decide on the business plans and investment plans of the company;
(IV) to formulate the company's proposed annual financial budgets and final accounts;
(V) to formulate the company's profit distribution plans and plans for making up losses;
(VI) to formulate plans for the company's increase or reduction of the registered capital or for the issuance of corporate;
(VII) to formulate plans for the merger, division, dissolution or change of corporate form of the company;
(VIII) to decide on the establishment of the company's internal management organization;
(IX) to decide on the employment or dismissal of the manager of the company and his remuneration, and to decide on the employment or dismissal of the deputy manager(s) and person(s) in charge of financial affairs of the company according to the recommendations of the manager and on their remuneration;
(X) to formulate the basic management system of the company; and
(XI) other functions and powers specified in the articles of association of the company.

Article 47: Meetings of the board of directors shall be convened and presided over by the chairman of the board. If the chairman of the board is unable to or does not perform his duty, the meeting shall be convened and presided over by the vice-chairman of the board. If the vice-chairman of the board is unable to or does not perform his duty, the meeting shall be convened and presided over by a director jointly designated by more than half of the directors.

Article 48: The method of deliberation and voting procedures of the board of directors shall be specified in the articles of association of the company, except where stipulated herein.

The board of directors shall keep minutes of its decisions on the matters under its consideration. The directors present at the meeting shall sign the minutes of the meeting.
When voting on a resolution of the board of directors, each director present at the meeting shall have one vote.

Article 49: A limited liability company may have a manager, who shall be employed or dismissed by the board of directors. The manager shall be accountable to the board of directors and shall exercise the following functions and powers:

(I) to be in charge of the production, operation and management of the company, and to organize the implementation of the resolutions of the board of directors;
(II) to organize the implementation of the annual business plans and investment plans of the company;
(III) to draft the plan for the establishment of the company's internal management organization;
(IV) to draft the basic management system of the company;
(V) to formulate the specific rules and regulations of the company;
(VI) to request the employment or dismissal of the deputy manager(s) and person (s) in charge of financial affairs of the company;
(VII) to decide on the employment or dismissal of management personnel other than those to be employed or dismissed by the board of directors; and
(VIII) other functions and powers delegated by the board of directors.

Where the articles of association of the company otherwise provide for the functions and powers of the manager, such provisions shall prevail.
The manager shall attend meetings of the board of directors as a non-voting attendee.

Article 50: A limited liability company with comparatively few shareholders or comparatively small in scale may have one executive director instead of a board of directors. The executive director may concurrently serve as the manager of the company.
The functions and powers of the executive director shall be specified in the articles of association of the company.

Article 51: A limited liability company shall have a board of supervisors, which shall have no fewer than three members. A limited liability company with comparatively few shareholders and comparatively small in scale may have one to two supervisors instead of a board of supervisors.
The board of supervisors shall include the representatives of the shareholders and an appropriate ratio of representatives of the company's staff and workers, in which the ratio of the staff and workers' representatives shall not be lower than one third. The specific ratio shall be specified in the articles of association of the company. The staff and workers' representatives on the board of supervisors shall be

democratically elected through the staff and workers' congress, the staff and workers' general meeting or other means.
The board of supervisors shall have a chairman that shall be elected by more than half of all supervisors. The chairman of the board of supervisors shall convene and preside over the meeting of the board of supervisors. If the chairman of the board of supervisors is unable to or does not perform his duty, the meeting of the board of supervisors shall be convened and presided over by a supervisor jointly designated by more than half of the supervisors.
Directors and senior officers may not concurrently serve as supervisors.

Article 52: The term of office of a supervisor shall be three years. If re-elected upon expiration of his term of office, a supervisor may serve consecutive terms.
If no new supervisor is elected in time upon expiration of the term of office of a supervisor, or if a supervisor resigns during his term of office, resulting in the number of members of the board of supervisors falling below the statutory number, the original supervisor shall perform his duties as supervisor according to the provisions of laws, administrative regulations and the articles of association of the company before a newly elected supervisor takes office.

Article 53: The board of supervisors or, in the case of a company without a board of supervisors, the supervisor shall exercise the following functions and powers:

(I) to examine the company's financial affairs;
(II) to supervise the execution of company duties by the directors and the senior officers and to recommend the removal of directors and senior officers that violate laws, administrative regulations, the articles of association of the company or the resolutions of general meeting;
(III) when an act of a director or senior officers is harmful to the company's interests, to require the director or senior officers to rectify such act;
(IV) to propose the convening of extraordinary general meeting and to convene and preside over the general meeting when the board of directors fails to perform the duties of convening and presiding over the general meeting as stipulated herein;
(V) to give proposals to the general meeting;
(VI) to institute proceedings against the directors and senior officers according to Article 152 hereof; and
(VII) other functions and powers specified in the articles of association of the company.

Article 54: supervisors may attend meetings of the board of directors as non-voting attendees and may make inquiries or suggestions to the matters to be resolved by the board of directors.
If the board of supervisors or, in the case of a company without a board of supervisors, a supervisor discovers irregularities in the operation of the company, it may conduct investigation. If necessary, an accounting firm may be engaged to assist in its or his work. The fees shall be borne by the company.

Article 55: The board of supervisors shall convene at least one meeting each year. supervisors may propose to convene an extraordinary meeting of the board of supervisors.
The method of deliberation and voting procedures of the board of supervisors shall be specified in the articles of association of the company, except where stipulated herein.
Resolutions of the board of supervisors shall be adopted by more than half of the supervisors.
The board of supervisors shall keep minutes of its decisions on the matters under its consideration. The supervisors present at the meeting shall sign the minutes of the meeting.

Article 56: The costs and expenses necessary for the board of supervisors or, in the case of a company without a board of supervisors, the supervisor to exercise their functions and powers shall be borne by the company.

Section 3: Special Provisions on One-Person Limited Liability Companies

Article 57: The provisions of this Section shall apply to the establishment and the organizational structure of one-person limited liability companies. For matters uncovered in this Section, the provisions of Section 1 and Section 2 of this Chapter shall apply.
For the purposes of the Law, the term "one-person limited liability company" refers to a limited liability company that has only one natural person shareholder or one legal person shareholder.

Article 58: A natural person may invest in and establish only one one-person limited liability company. Such one-person limited liability company may not invest in and establish a new one-person limited liability company.

Article 59: A one-person limited liability company shall indicate whether it is wholly owned by a natural person or wholly owned by a legal person in the company registration, and specify the same in the business license of the company.

Article 60: The articles of association of a one-person limited liability company shall be formulated by the shareholder.

Article 61: A one-person limited liability company shall not have a board of shareholders. When the shareholder makes a decision that falls under Paragraph 1 of Article 38 hereof, it shall be in writing and be kept in the company after it is signed by the shareholder.

Article 62: A one-person limited liability company shall prepare, at the end of each fiscal year, a financial and accounting report that is audited by an accounting firm.

Article 63: If the shareholder of a one-person limited liability company is unable to prove that the property of the company is independent from the shareholder's own property, the shareholder shall bear joint and several liability for the debts of the company.

Section 4: Special Provisions on Wholly State-Owned Companies

Article 64: The provisions of this Section shall apply to the establishment and the organizational structure of wholly State-owned companies. For any matter uncovered in this Section, the provisions of Section 1 and Section 2 of this Chapter shall apply.
For the purposes of the Law, the term "wholly State-owned company" refers to a limited liability company of which the State is the sole investor and the State Council or a local people's government authorizes a State-owned assets supervision and administration authority of the people's government at the same level to perform the responsibilities of the investor.

Article 65: The articles of association of a wholly State-owned company shall be formulated by the State-owned assets supervision and administration authority or drafted by the board of directors and submitted to the State-owned assets supervision and administration authority for approval.

Article 66: A wholly State-owned company shall not have a board of shareholders. The functions and powers of the board of shareholders shall be exercised by the State-owned assets supervision and administration authority. The State-owned assets supervision and administration authority may authorize the company's board of directors to exercise part of the functions and powers of the board of shareholders and to decide on the major matters of the company. However, merger, division, dissolution, increase or reduction of registered capital and issuance of corporate bonds of the company shall be decided by the State-owned assets supervision and administration authority. Merger, division, dissolution or bankruptcy application of important wholly State-owned companies shall, after examination and verification by the State-owned assets supervision and administration authority, be reported to the people's government at the same level for approval.
The "important wholly State-owned companies" referred to in the preceding paragraph shall be determined in accordance with the provisions of the State Council.

Article 67: A wholly State-owned company shall have a board of directors, which shall exercise functions and powers in accordance with Articles 47 and 67 hereof. The term of office of directors shall not exceed three years. The members of the board of directors shall include representatives of the staff and workers.
The members of the board of directors shall be appointed by the State-owned assets supervision and administration authority. However, the representatives of the staff and workers among the members of the board of directors shall be elected by the staff and workers' congress of the company.
The board of directors shall have one chairman of the board, and may have a vice-chairman of the board. The chairman of the board and vice-chairman of the board shall be designated by the State-owned assets supervision and administration authority from among the members of the board of directors.

Article 68: A wholly State-owned company shall have a manager, who shall be engaged or dismissed by the board of directors. The manager shall exercise functions and powers in accordance with Article 50 hereof.
Subject to approval by the State-owned assets supervision and administration authority, a member of the board of directors may serve concurrently as manager.

Article 69: The chairman of the board, vice-chairman of the board, directors or senior officers of a wholly State-owned company may not concurrently serve in another limited liability company, company limited by shares or other business organization without the approval of the State-owned assets supervision and administration authority.

Article 70: The board of supervisors of a wholly State-owned company shall have no fewer than five members, among which the ratio of representatives of staff and workers shall not be lower than one third. The specific ratio shall be specified in the articles of association of the company.
The members of the board of supervisors shall be appointed by the State-owned assets supervision and administration authority. However, the representatives of the staff and workers amongst the members of the board of supervisors shall be elected by the staff and workers' congress of the company. The chairman of the board of supervisors shall be designated by the State-owned assets supervision and administration authority from among the members of the board of supervisors.
The board of supervisors shall exercise the functions and powers stipulated in Items (1) to (3) of Article 54 hereof and other functions and powers stipulated by the State Council.

Chapter III: Transfer of Equity Interests in Limited Liability Companies

Article 71: The shareholders of a limited liability company may transfer all or part of their equity interests among them.
Where a shareholder transfers its equity interests to a person other than a shareholder, it shall obtain the consent of more than half of the other shareholders. The shareholder shall notify the other shareholders in writing of the transfer of equity interests and seek their consent. Where the other shareholders do not reply within 30 days of receipt of the written notice, they shall be deemed to consent to the transfer. If more than half of the other shareholders do not consent to the transfer, the dissenting shareholders shall purchase the equity interests to be transferred. If they do not purchase the equity interests, they shall be deemed to consent to the transfer.
Provided all conditions are equal, the other shareholders shall have the priority purchase right for the equity interests the transfer of which has been consented by the shareholders. If two or more shareholders exercise the priority purchase right, they shall determine their respective purchase ratio upon consultation. If consultation fails, they shall exercise the priority purchase right in proportion to their respective ratio of capital contribution at the time of the transfer.
Where the articles of association of the company otherwise provide for transfer of equity interests, such provisions shall prevail.

Article 72: When a people's court transfers the equity interests of a shareholder pursuant to the enforcement procedures stipulated in law, it shall notify the company and all shareholders, and the other shareholders shall have the priority purchase right under equal conditions. Where the other shareholders fail to exercise the priority purchase right within 20 days of the date of notice of the people's court, they shall be deemed to waive their priority purchase right.

Article 73: After an equity interest is transferred pursuant to Article 72 or Article 73 hereof, the company shall cancel the capital contribution certificate of the original shareholder, issue a capital contribution certificate to the new shareholder and amend the records of the relevant shareholder and its capital contribution in the articles of association and the register of shareholders of the company. Such amendment to the articles of association of the company does not require a resolution by the board of shareholders.

Article 74: In any of the following circumstances, a shareholder that votes against the resolution of the board of shareholders may request the company to purchase its equity interests at a reasonable price:

(I) the company has not distributed its profits to the shareholders for five consecutive years, while the company has been profitable for five consecutive years and meets the conditions for distribution of profit stipulated herein;
(II) the company is merged or divided, or transfers its major property; or
(III) the term of operation specified in the articles of association of the company expires or any other reason for dissolution specified in the articles of association arises, and the general meeting has adopted a resolution to amend the articles of association to allow the continual existence of the company.

If the shareholder and the company fail to reach an agreement on the purchase of equity interests within 60 days of the adoption of the resolution of the general meeting, the shareholder may institute proceedings in a people's court within 90 days of the adoption of the resolution of the general meeting.

Article 75: After a natural person shareholder dies, his legal heir may inherit his shareholder status, except where the articles of association of the company stipulate otherwise.

Chapter IV: Establishment and Organizational Structure of Companies Limited by Shares

Section 1: Establishment

Article 76: The following conditions shall be fulfilled for the establishment of a company limited by shares:

(I) the number of promoters conforms to the quorum requirement;
(II) the total amount of share capital subscribed for or the total paid-up share capital raised by all the sponsors specified in the articles of association of the company;

(III) the share issue and preparation matters conform to laws and regulations;
(IV) the company's articles of association have been formulated by the promoters; in the case of establishment by means of share offer, the articles of association shall have been adopted at the inaugural meeting;
(V) the company has a name, and an organizational structure established in accordance with the requirements for companies limited by shares; and
(VI) the company has a domicile.

Article 77: Companies limited by shares may be established by means of promotion or by means of share offer.
The term "establishment by means of promotion" refers to establishment of a company by means of subscription by the promoters for all the shares to be issued by the company.
The term "establishment by means of share offer" refers to establishment of a company by means of subscription by the promoters for a portion of the shares to be issued by the company, and offer of the balance to the public or to specified targets.

Article 78: For the establishment of a company limited by shares, there shall be more than two and less than 200 promoters, of which more than half shall have their domicile within the territory of the People's Republic of China (hereinafter referred to as "China").

Article 79: The promoters of a company limited by shares shall undertake the matters concerning preparation of the establishment of the company.
They shall conclude a promoters' agreement that stipulates the rights and obligations of each party during the process of establishment of the company.

Article 80: Where a company limited by shares is established by means of promotion, the registered capital shall be the total share capital subscribed for by all promoters as registered with the company registration authority. Before the capital for the equity shares subscribed for by all promoters are paid in full, the offer of shares to others may not be carried out.
Where a company limited by shares is established by means of share offer, the registered capital shall be the total paid-up share capital as registered with the company registration authority.
Where laws, administrative regulations and the decisions of the State Council otherwise stipulate the actual paid registered capital and the minimum registered capital of companies limited by shares, such provisions shall prevail.

Article 81: The articles of association of a company limited by shares shall specify the following particulars:

(I) the name and domicile of the company;
(II) the scope of business of the company;
(III) the method of establishment of the company;
(IV) the total number of shares of the company, the price per share and the registered capital;

(V) the names of and number of shares subscribed for by the promoters, and their methods and time of capital contribution;
(VI) the composition, functions and powers and rules of procedure of the board of directors;
(VII) the legal representative of the company;
(VIII) the composition, functions and powers and rules of procedure of the board of supervisors;
(IX) the method of distribution of company profit;
(X) the reasons for dissolution of the company and method of liquidation;
(XI) methods for notices and announcements of the company; and
(XII) other matters that the general meeting considers necessary to be specified.

Article 82: The methods of capital contribution of promoters shall be governed by Article 27 hereof.

Article 83: Where a company limited by shares is established by means of promotion, the promoters shall subscribe in writing for all the shares for which they subscribe as specified in the company's articles of association, and pay the capital contribution according to the articles of association of the company. Where capital contribution is made in non-currency property, procedures for transfer of their property rights shall be handled according to the law.
Where a promoter does not make capital contribution according to the provisions in the preceding paragraph, it shall be liable for breach of contract according to the promoters' agreement.
After the promoters subscribe the contribution for which they subscribe as specified in the company's articles of association, they shall elect the board of directors and board of supervisors. The board of directors shall submit to the company registration authority the company's articles of association and other documents specified in laws and administrative regulations, and apply for registration of establishment.

Article 84: If a company limited by shares is established by means of share offer, the shares subscribed for by the promoters may not be less than 35% of the total number of company shares, unless where there are other stipulations in laws and administrative regulations, such stipulations shall prevail.

Article 85: When promoters offer shares to the public, they shall publish the share prospectus and prepare subscription forms. The subscription forms shall specify the particulars listed in Article 87 hereof. The subscribers shall enter the number and amount of shares subscribed for and their domiciles on the forms, and shall sign and seal such forms. Subscribers shall pay subscription monies in accordance with the number of shares they subscribed for.

Article 86: A share prospectus shall have the company's articles of association formulated by the promoters attached, and shall specify the following particulars:

(I) the number of shares subscribed for by the promoters;
(II) the face value and issue price of each share;
(III) the total number of bearer shares issued;
(IV) the purpose of the funds raised;
(V) the rights and obligations of subscribers; and
(VI) the opening and closing dates of the share offer and a statement to the effect that subscribers may withdraw their share subscriptions if all the shares are not taken up within the time limit.

Article 87: When promoters offer shares to the public, the shares shall be distributed by a securities company established according to the law, with which a distribution agreement shall be concluded.

Article 88: If promoters are to offer shares to the public, they shall conclude an agreement with a bank on the collection of subscription monies on behalf of the company.
The bank accepting subscription monies on behalf of the company shall accept and keep the subscription monies on behalf of the company in accordance with the agreement, and issue receipts to subscribers paying their subscription monies. In addition, the bank shall assume an obligation to issue certification of receipt of subscription monies to the relevant authority.

Article 89: After full payment of the subscription monies for a share issue, capital verification shall be carried out by a capital verification institution established according to the law, which shall issue certificates. The promoters shall convene and preside over the inaugural meeting of the company within 30 days after full payment of subscription monies. The inaugural meeting shall be composed of the promoters and subscribers.
If the shares issued are not fully taken up by the cut off time specified in the share prospectus or if the promoters fail to convene the inaugural meeting within 30 days after full payment of the subscription monies for the share issue, the subscribers may claim a refund from the promoters according to the subscription monies paid plus bank deposit interest calculated for the same period.

Article 90: The promoters shall notify all subscribers or make an announcement 15 days prior to convening of the inaugural meeting, which may be held only if attended by the promoters and subscribers representing more than half of the total number of shares.
The following functions and powers shall be exercised at an inaugural meeting:

(I) to deliberate the promoters' report concerning preparation of the establishment of the company;
(II) to approve the articles of association of the company;

(III) to elect the members of the board of directors;
(IV) to elect the members of the board of supervisors;
(V) to examine and approve the establishment fees of the company;
(VI) to examine and approve the value at which promoters substituted property for subscription monies; and
(VII) if force majeure or a major change in business conditions occurs and directly affects the establishment of the company, a resolution of not establishing the company may be passed.

For the inaugural meeting to pass resolutions concerning the matters stated in the preceding paragraph, they shall be adopted by subscribers present at the meeting representing more than half of the voting rights.

Article 91: After promoters and subscribers pay their subscription monies or make their capital contributions as substitutes for subscription monies, they may not withdraw their share capital, except where the shares are not fully taken up on time, the promoters fail to convene the inaugural meeting on time or a resolution not to establish the company is adopted at the inaugural meeting.

Article 92: The board of directors shall, within 30 days after the end of the inaugural meeting, submit the following documents and apply for registration of establishment to the company registration:

(I) the application for company registration;
(II) the minutes of the inaugural meeting;
(III) the articles of association of the company;
(IV) the capital verification certificates;
(V) the employment documents for the legal representative, directors and supervisors, and their proof of identity;
(VI) the proof of legal person status of the promoters or the proof of identity of natural persons; and
(VII) the proof of domicile of the company.

Where the company limited by shares that is established by means of share offer issues shares to the public, it shall also submit the verification and approval document of the State Council's securities regulatory authority to the company registration authority.

Article 93: Where a promoter fails to make his capital contribution in full according to the stipulations of the company's articles of association after the company limited by shares is established, he shall make up the outstanding sum, and the other promoters shall bear joint and several liability.
Where, after the company limited by shares is established, it is discovered that the actual price of the non-currency property contributed as capital for establishment of company is markedly lower than the price specified in the company's articles of association; the discrepancy shall be made up by the promoter that delivered the capital contribution. Other promoters shall bear joint and several liability.

Article 94: The promoters of a company limited by shares shall bear the following liabilities:

(I) if the company cannot be established, joint and several liability for the debts and expenses occasioned during the establishment activities;
(II) if the company cannot be established, joint and several liability for refunding the subscription monies already paid by subscribers plus bank deposit interest calculated for the same period; and
(III) if during the course of establishment of the company, the company's interests are harmed due to the fault of the promoters, liability towards the company for compensation.

Article 95: When a limited liability company is converted into a company limited by shares, the total amount of paid-up share capital converted shall not exceed the amount of net assets of the company. When a limited liability company that is converted into a company limited by shares offers shares to the public in order to increase its capital, such issue shall be carried out according to the law.

Article 96: Companies limited by shares shall keep at their office the company's articles of association, register of shareholders, counterfoil of corporate bonds, minutes of general meetings, minutes of the meetings of the board of directors, minutes of the meetings of the board of supervisors, and financial and accounting reports.

Article 97: Shareholders shall have the right to examine the articles of association of the company, register of shareholders, counterfoil of corporate bonds, minutes of general meetings, minutes of the meetings of the board of directors, minutes of the meetings of the board of supervisors, and financial and accounting reports, and to give suggestions for or inquire about the operation of the company.

Section 2: General Meeting

Article 98: The general meeting of a company limited by shares shall be composed of all shareholders. The general meeting shall be the organ of authority of the company and shall exercise its functions and powers in accordance with the Law.

Article 99: The provisions of Paragraph 1 of Article 38 hereof on the functions and powers of the board of shareholders of limited liability companies shall apply to the general meeting of companies limited by shares.

Article 100: The annual general meeting of the general meeting shall be held once every year. An extraordinary general meeting shall be convened within two months of the occurrence of any of the following circumstances:

(I) the number of directors is less than the number stipulated herein or less than two thirds of the number specified in the articles of association of the company;
(II) the losses of the company that have not been made up reach one third of the total paid-up share capital;

(III) it is requested by a shareholder that independently holds, or by the shareholders that hold in aggregate, 10% or more of the company's shares;
(IV) it is considered necessary by the board of directors;
(V) it is proposed by the board of supervisors; or
(VI) other circumstances specified by the articles of association of the company.

Article 101: The general meeting shall be convened by the board of directors and presided over by the chairman of the board. If the chairman of the board is unable to or does not perform his duty, the meeting shall be presided over by the vice-chairman of the board. If the vice-chairman of the board is unable to or does not perform his duty, the meeting shall be presided over by a director jointly designated by more than half of the directors.
If the board of directors is unable to or does not perform the duty of convening the general meeting, the meeting shall be convened and presided over by the board of supervisors in a timely manner. If the board of supervisors does not convene and preside over the meeting, a shareholder that has independently held, or the shareholders that have held in aggregate, 10% or more of the shares of the company for 90 or more consecutive days may themselves convene and preside over the meeting.

Article 102: If a general meeting is to be convened, all shareholders shall be notified of the time and venue of the meeting and the matters to be considered at the meeting 20 days before the meeting is held. In the case of an extraordinary general meeting, the shareholders shall be notified 15 days before the meeting is held. If bearer shares are to be issued, the time and venue of the meeting and the matters to be considered at the meeting shall be announced 30 days before the meeting is held.
A shareholder that independently holds, or the shareholders that hold in aggregate, 3% or more of the shares of the company may submit an extraordinary resolution in writing to the board of directors at least 10 days before a general meeting is held. The board of directors shall notify the other shareholders within two days of receipt of the resolution and submit the extraordinary resolution to the general meeting for consideration. The contents of the extraordinary resolution shall be within the scope of authority of the general meeting and shall have a clear subject and specific matters for resolution.
No resolution may be adopted by a general meeting on any matter uncovered in the notices specified in the preceding two paragraphs.
Holders of bearer shares that intend to attend a general meeting shall deposit their share certificates with the company for a period beginning from five days before the meeting is held to the adjournment of the meeting.

Article 103: Shareholders present at a general meeting shall be entitled to one vote for each share held. However, there shall be no voting right for the shares of the company held by the company itself.
Resolutions of a general meeting shall be adopted by more than half of the voting rights held by the shareholders present at the meeting. However, resolutions of a general meeting to amend the company's articles of association, to increase or

reduce the registered capital, or on merger, division, dissolution or change of the corporate form of the company shall be adopted by two thirds or more of the voting rights held by the shareholders present at the meeting.

Article 104: If it is stipulated in the Law and the articles of association of the company that a resolution shall be adopted by the general meeting on matters such as transfer of major assets by or to the company or provision of security for an external party, the board of directors shall promptly convene a general meeting, and the general meeting shall vote on such matters.

Article 105: In the case of election of directors and supervisors of a general meeting, the cumulative voting system may be implemented in accordance with the provisions of the articles of association of the company or the resolution of the general meeting.
For the purposes of the Law, the term "cumulative voting system" refers to that when a general meeting elects a director or supervisor, the number of voting rights attached to each share is the same as the number of directors or supervisors to be elected, and that the voting rights held by a shareholder may be exercised collectively.

Article 106: A shareholder may appoint a proxy to attend a general meeting on his behalf. The proxy shall submit the shareholder's power of attorney to the company and exercise voting rights within the scope of authorization.

Article 107: The general meeting shall keep minutes of the decisions on the matters under its consideration, and the presiding person and the directors present at the meeting shall sign the minutes of the meeting. The minutes of the meeting shall be kept together with the sign-in book of the attending shareholders and the powers of attorney of the attending proxies.

Section 3: Board of Directors and Manager

Article 108: A company limited by shares shall have a board of directors of five to 19 members.
The members of the board of directors may include representatives of the staff and workers of the company. The representatives of the staff and workers among the members of the board of directors shall be democratically elected by the staff and workers of the company through the staff and workers' congress, the staff and workers' general meeting or other means.
The provisions of Article 46 hereof on the term of office of the directors of limited liability companies shall apply to the directors of companies limited by shares.
The provisions of Article 47 hereof on the functions and powers of the board of directors of limited liability companies shall apply to the board of directors of companies limited by shares.

Article 109: The board of directors shall have one chairman of the board and may have a vice-chairman (or vice-chairmen) of the board. The chairman and

vice-chairman (or vice-chairmen) of the board shall be elected by more than half of all directors.
The chairman of the board shall convene and preside over the meetings of the board of directors and inspect the implementation of the resolutions of the board of directors. The vice-chairman of the board shall assist the chairman of the board in his work. Where the chairman of the board is unable to or does not perform his duties, his duties shall be performed by the vice-chairman. If the vice-chairman is unable to or does not perform his duties, his duties shall be performed by a director jointly designated by more than half of the directors.

Article 110: The board of directors shall convene at least two meetings each year. All directors and supervisors shall be notified 10 days before each meeting is held.
An extraordinary meeting of the board of directors may be proposed by shareholders representing 10% or more of the voting rights or one third or more of the directors or the board of supervisors. The chairman of the board shall convene and preside over the meeting of the board of directors within 10 days of receipt of the proposal.
The notification method and time limit for giving notice of the convening of extraordinary meetings of the board of directors may be decided separately.

Article 111: Meetings of the board of directors may be held only if attended by more than half of the directors. Resolutions of the board of directors shall be adopted by more than half of all directors.
When voting on a resolution of the board of directors, each member shall have one vote.

Article 112: Meetings of the board of directors shall be attended by the directors in person. If a director for any reason is unable to attend the meeting, he may appoint another director in writing to attend the meeting on his behalf, and the power of attorney shall specify the scope of authorization.
The board of directors shall keep minutes of its decisions on the matters under its consideration, and the directors present at the meeting shall sign the minutes of the meeting.
The directors shall bear liability for the resolutions of the board of directors. If a resolution of the board of directors violates any law or administrative regulation, or the company's articles of association or a resolution of the general meeting, thereby causing the company to incur serious losses, the directors that took part in such resolution shall be liable to the company for compensation. However, if a director is proved to have expressed his objection to the resolution at the time of voting and the objection is recorded in the minutes of the meeting, such director may be released from such liability.

Article 113: A company limited by shares shall have a manager, who shall be engaged or dismissed by the board of directors.
The provisions of Article 50 hereof on the functions and powers of the manager of limited liability companies shall apply to the manager of companies limited by shares.

Article 114: The board of directors of a company may decide that a member of the board of directors shall serve concurrently as the manager.

Article 115: A company shall not directly or through a subsidiary provide any loan to its directors, supervisors or senior officers.

Article 116: A company shall periodically disclose to its shareholders the remuneration received by its directors, supervisors and senior officers from the company.

Section 4: Supervisor Board of Supervisors

Article 117: A company limited by shares shall have a board of supervisors of no fewer than three members.
The board of supervisors shall include representatives of the shareholders and an appropriate ratio of the representatives of the company's staff and workers, where the ratio of the staff and workers' representatives shall not be less than one third. The specific ratio shall be specified in the articles of association of the company. The staff and workers' representatives on the board of supervisors shall be democratically elected through the staff and workers' congress, the staff and workers' general meeting or other means.
The board of supervisors shall have a chairman and may have a vice-chairman (or chairmen). The chairman and vice-chairman of the board of supervisors shall be elected by more than half of all supervisors. The chairman of the board of supervisors shall convene and preside over the meetings of the board of supervisors. If the chairman of the board of supervisors is unable to or does not perform his duty, the meetings of the board of supervisors shall be convened and presided over by the vice-chairman of the board of supervisors. If the vice-chairman of the board of supervisors is unable to or does not perform his duty, the meetings of the board of supervisors shall be convened and presided over by a supervisor jointly designated by more than half of the supervisors.
Directors and senior officers may not concurrently serve as supervisors.
The provisions of Article 53 hereof on the term of office of the supervisors of limited liability companies shall apply to the supervisors of companies limited by shares.

Article 118: The provisions of Articles 54 and 55 hereof on the functions and powers of the board of supervisors of limited liability companies shall apply to the board of supervisors of companies limited by shares.
The costs and expenses necessary for the board of supervisors to exercise its functions and powers shall be borne by the company.

Article 119: The board of supervisors shall convene at least one meeting every six months. The supervisors may propose to convene an extraordinary meeting of the board of supervisors.
The method of deliberation and the voting procedures of the board of supervisors shall be specified in the articles of association of the company, except where stipulated herein.

Resolutions of the board of supervisors shall be adopted by more than half of the supervisors.
The board of supervisors shall keep minutes of its decisions on the matters under its consideration. The supervisors present at the meeting shall sign the minutes of the meeting.

Section 5: Special Provisions on the Organizational Structure of Listed Companies

Article 120: For the purposes of the Law, the term "listed company" refers to a company limited by shares whose shares are listed and traded on a stock exchange.

Article 121: If the amount of the major assets purchased or sold or the amount of security provided by a listed company within one year exceeds 30% of the total assets of the company, a resolution shall be passed by the general meeting and adopted by two thirds or more of the voting rights held by the shareholders present at the meeting.

Article 122: A listed company shall have independent directors. The specific procedures thereon shall be stipulated by the State Council.

Article 123: A listed company shall have a secretary to the board of directors to be in charge of matters such as the preparation of the general meetings and the meetings of the board of directors of the company, the safekeeping of documents as well as the administration of the shareholders' information of the company and the handling of information disclosure.

Article 124: If a director of a listed company is affiliated with an enterprise involved in a resolution matter of the meeting of the board of directors, he may not exercise his voting right on such resolution or the voting right of any other director as proxy. Such meeting of the board of directors may be held if attended by more than half of the directors without such affiliation, and the resolution of the meeting of the board of directors shall be adopted by more than half of the directors without such affiliation. If the number of directors without such affiliation present at the meeting of the board of directors is less than three, the matter shall be submitted to the general meeting of the listed company for consideration.

Chapter V: Issuance and Transfer of Shares in Companies Limited by Shares

Section 1: Issuance of Shares

Article 125: The capital of companies limited by shares shall be divided into shares of equal amount.
The shares of companies shall take the form of share certificates. Share certificates shall be the vouchers issued by companies evidencing the shares held by their shareholders.

Article 126: Shares shall be issued in accordance with the principles of equitability and fairness. Each share of the same type shall carry the same rights and benefits.

Shares of the same type in the same issue shall be issued on the same conditions and at the same price. The same price shall be payable for each of the shares subscribed for by any work unit or individual.

Article 127: Shares may be issued at or above par but not below par.

Article 128: Share certificates shall be of paper or in such other form as determined by the State Council's securities regulatory authority.
The following main particulars shall be clearly stated on a share certificate:

(I) the name of the company;
(II) the date of establishment of the company;
(III) the class and face value of the share certificate and the number of shares it represents; and
(IV) the serial number of the share certificate.

Share certificates shall be signed by the legal representative and sealed by the company.
The words "promoters' share certificate" shall be clearly indicated on share certificates of promoters.

Article 129: Shares issued by a company may be registered shares and may also be bearer shares.
Shares issued by a company to a promoter or a legal person shall be registered shares and shall bear the name of such promoter or legal person. No separate account with a different name may be opened for such shares, nor may such shares be registered in the name of a representative.

Article 130: Companies that issue registered shares shall establish share registers, in which the following particulars shall be recorded:

(I) the names and domiciles of the shareholders;
(II) the number of shares held by each shareholder;
(III) the serial numbers of the share certificates held by each shareholder; and
(IV) the date on which each shareholder obtained the shares.

Companies that issue bearer shares shall record the number, serial numbers and issue date of the share certificates.

Article 131: The State Council may formulate separate regulations for the issue by companies of shares of types other than those provided for in the Law.

Article 132: Companies limited by shares shall formally deliver the share certificates to their shareholders immediately upon establishment. Companies may not deliver share certificates to their shareholders prior to establishment.

Article 133: When a company issues new shares, resolutions in respect of the following matters shall be adopted by the general meeting:

(I) the class and amount of the new shares;
(II) the issue price of the new shares;
(III) the opening and closing dates of the new share issue; and
(IV) the class and amount of new shares issued to existing shareholders.

Article 134: When a company issues new shares to the public upon verification and approval by the State Council's securities regulatory authority, it shall announce a prospectus for the new shares and financial and accounting reports, and prepare subscription forms.
The provisions of Articles 88 and 89 hereof shall apply to the issue of new shares to the public by companies.

Article 135: The pricing proposal for new shares to be issued by a company may be determined on the basis of its operation and financial status.

Article 136: After a company has raised the full amount of subscription monies from a new share issue, it shall register the change with the company registration authority and make an announcement.

Section 2: Transfer of Shares

Article 137: Shares held by shareholders may be transferred according to the law.

Article 138: Transfer of shares by shareholders shall be conducted at a securities trading place established according to the law or by other means as stipulated by the State Council.

Article 139: Registered shares shall be transferred by means of endorsement by the shareholder or by other means stipulated in laws and administrative regulations. After the transfer, the company shall record the name and domicile of the transferee in the register of shareholders.
No change registration shall be carried out in respect of the register of shareholders specified in the preceding paragraph within 20 days prior to convening a general meeting or within 5 days prior to the reference date determined by the company for the distribution of dividends. However, where the law has stipulated otherwise on the change registration of the register of shareholders of listed companies, such stipulations shall prevail.

Article 140: A transfer of bearer shares shall become effective immediately upon delivery of the shares by the shareholder to the transferee.

Article 141: Shares held by the promoters in the company promoted may not be transferred within one year of the date of establishment of the company. Shares issued by a company prior to the public offer of its shares may not be transferred within one year of the date of listing of its shares on a stock exchange.
A director, supervisor or senior officers of a company shall declare to the company the number of shares in the company held by him and any change thereof, and may

not transfer more than 25% of the shares in the company held by him each year during his term of office. The shares held by him may not be transferred within one year of the date of listing of the company's shares. The aforementioned person may not transfer the shares in the company he holds within six months after he leaves office. The articles of association of the company may specify other restrictive provisions on the transfer of the company's shares held by the directors, supervisors and senior officers of the company.

Article 142: A company may not purchase its own shares except in any of the following circumstances:

(I) to reduce the registered capital of the company;
(II) to merge with another company (companies) that hold(s) its shares;
(III) to reward the staff and workers of the company with shares; or
(IV) a shareholder requests the company to purchase the shares held by him since he objects to a resolution of the general meeting on the merger or division of the company.

Where a company purchases its own shares for reasons specified in Items (I) to (III) of the preceding paragraph, a resolution of the general meeting shall be adopted. Shares purchased by the company pursuant to the preceding paragraph shall be cancelled within 10 days of the date of purchase if the circumstances fall under Item (I), or transferred or cancelled within six months if the circumstances fall under Item (II) or (IV).
A company's own shares purchased by the company pursuant to Item (III) of Paragraph One shall not exceed 5% of the total issued shares of the company. The funds used for the purchase shall be taken from the after-tax profits of the company, and the shares purchased shall be transferred to the staff and workers within one year.
A company may not accept its own shares as the subject matter of a pledge.

Article 143: If a registered share certificate is stolen, lost or destroyed, the shareholder may petition to a people's court to declare the certificate void in accordance with the procedures for public invitation to assert claims as specified in Civil Procedure Law of the People's Republic of China. After the people's court has declared such share certificate void, the shareholder may apply to the company for a new share certificate.

Article 144: Shares of a listed company shall be listed and traded in accordance with the relevant laws, administrative regulations and the trading rules of stock exchanges.

Article 145: A listed company shall disclose its financial status, business condition and major litigation according to the provisions of laws and administrative regulations, and shall publish a financial and accounting report once every six months in each fiscal year.

Chapter VI: Qualifications and Obligations of Directors, Supervisors and Senior Officers of Companies

Article 146: A person may not serve as a company's director, supervisor or senior officers if he is:

(I) a person with no or limited capacity for civil acts;
(II) a person that was sentenced to criminal punishment for the crime of corruption, bribery, encroachment of property, misappropriation of property or disruption of the order of the socialist market economy, and not more than five years has elapsed since the expiration of the enforcement period; or a person that was deprived of his political rights for committing a crime, and not more than five years has elapsed since the expiration of the enforcement period;
(III) a director, factory director or manager of a company or enterprise liquidated upon bankruptcy that was personally responsible for the bankruptcy of the company or enterprise, and not more than three years has elapsed since the date of completion of the bankruptcy liquidation;
(IV) the legal representative of a company or enterprise that had its business license revoked and had been closed down by order for violation of law, for which such representative bears individual liability, and not more than three years has elapsed since the date on which the business license of the company or enterprise was revoked; and
(V) a person with a comparatively large amount of personal debts due and unsettled.

If a company elects or appoints a director or supervisor or employs senior officers in violation of the preceding paragraph, such election, appointment or employment shall be invalid.
If a director, supervisor or senior officers falls under the circumstances specified in Paragraph One of this Article during his term of office, the company shall dismiss him from his office.

Article 147: Directors, supervisors and senior officers shall abide by laws, administrative regulations and the articles of association of the company, and have a fiduciary obligation and obligation of diligence to the company.
Directors, supervisors and senior officers may not take advantage of their positions and powers to collect or accept bribes or other illegal income, and may not encroach upon the property of the company.

Article 148: Directors and senior officers may not have the following acts:

(I) misappropriate the funds of the company;
(II) deposit the funds of the company in an account opened in his personal name or in the name of another individual;
(III) in violation of the articles of association of the company, lend the funds of the company to other persons or use the property of the company to provide

security for other persons without the consent of the board of shareholders, general meeting or the board of directors;

(IV) enter into a contract or transaction with the company in violation of the articles of association of the company or without the consent of the board of shareholders or general meeting;

(V) take advantage of the convenience of his position to seek for himself or other persons commercial opportunities that belong to the company or to operate by himself or for another person the same type of business as that of his company without the consent of the board of shareholders or general meeting;

(VI) accept as his own the commissions of a transaction between another person and the company;

(VII) disclose the secrets of the company without authorization; or

(VIII) other acts that violate his fiduciary obligation to the company.

The income derived by a director or senior officers from violating the provisions of the preceding paragraph shall belong to the company.

Article 149: If a director, supervisor or senior officers violates the provisions of laws, administrative regulations or the articles of association of the company in the execution of company duties, thereby causing losses to the company, he shall be liable for compensation.

Article 150: If a director, supervisor or senior officers is required by the board of shareholders or general meeting to attend the meeting as non-voting attendee, the director, supervisor or senior officers shall attend the meeting as a non-voting attendee and accept inquiries from the shareholders.

Directors and senior officers shall truthfully provide the relevant information and materials to the board of supervisors or, in the case of a limited liability company without a board of supervisors, the supervisor, and may not obstruct the board of supervisors or supervisors in exercising its/their functions and powers.

Article 151: If a director or senior officers is in the circumstances specified in Article 150 hereof, the shareholders in the case of a limited liability company, or a shareholder that has independently held, or the shareholders that have held in aggregate, 1% or more of the shares of the company for more than 180 consecutive days in the case of a company limited by shares, may request in writing the board of supervisors or, the supervisors, in the case of a limited liability company without a board of supervisors, to institute proceedings with the people's court; where the supervisors fall under the circumstance set forth in Article 150 hereof, the foregoing shareholders may request in writing the board of directors or, the executive directors, in the case of a limited liability company without a board of directors, to institute proceedings with the people's court.

If the board of supervisors or, in the case of a limited liability company without a board of supervisors, the supervisor, or the board of directors or executive director refuses to institute proceedings after receipt of the written request of the shareholder as specified in the preceding paragraph, or fails to institute proceedings within

30 days of the date of receipt of the request, or if the matter is urgent and failure in the immediate institution of proceedings would result in damage to the interests of the company that is difficult to remedy, the shareholder(s) specified in the preceding paragraph shall have the right to directly institute proceedings in his or their name in a people's court for the interests of the company.
If any other person infringes upon the lawful rights and interests of the company and thereby causing losses to the company, the shareholder(s) specified in Paragraph One of this Article may institute proceedings in a people's court pursuant to the provisions of the preceding two paragraphs.

Article 152: If, in violation of the provisions of laws, administrative regulations or the articles of association of the company, a director or senior officers harms the interests of the shareholders, the shareholders may institute proceedings in a people's court.

Chapter VII: Corporate Bonds

Article 153: For the purposes of the Law, the term "corporate bonds" refers to valuable securities issued by a company in accordance with statutory procedure, the principal of which such company agrees to repay, together with interest, within a definite time limit.
Issue of corporate bonds by companies shall comply with the conditions for issue stipulated in Securities Law of the People's Republic of China.

Article 154: After an issuing company's application for issuing corporate bonds has been verified and approved by the department authorized by the State Council, it shall announce the method of offer of the corporate bonds.
The method of offer of corporate bonds shall specify the following main particulars:

(I) the name of the company;
(II) the purpose of the funds from the offer of the corporate bonds;
(III) the total amount and the face value of the bonds;
(IV) the method of determining the interest rate of the bonds;
(V) the time limit for and method of repayment of the principal together with the interest thereon;
(VI) the details of the guarantee for bonds;
(VII) the bond price and the opening and closing dates of the bond issue;
(VIII) the amount of the company's net assets;
(IX) the total amount of previously issued corporate bonds that have not yet matured; and
(X) the distributor of the corporate bonds.

Article 155: When a company issues corporate bonds in scrip form, it shall clearly record particulars such as the name of the company, the face value of the bond, the interest rate and the time limit for repayment, and the bonds shall be signed by the legal representative and sealed by the company.

Article 156: Corporate bonds may be registered bonds and may also be bearer bonds.

Article 157: When issuing corporate bonds, a company shall prepare a corporate bond counterfoil book.
In the case of issuance of registered corporate bonds, the following particulars shall be recorded in the corporate bond counterfoil book:

(I) the names and domiciles of the bondholders;
(II) the dates on which the bondholders obtained the bonds and the serial numbers thereof;
(III) the total amount of the bonds, the face value and the interest rate of the bonds, and the time limit for and method of repayment of the principal together with the interest thereon; and
(IV) the date of issue of the bonds.

In the case of issuance of bearer corporate bonds, the following particulars shall be recorded in the corporate bond counterfoil book: the total amount of the bonds, the interest rate, the time limit for and method of repayment, the date of issue and the serial number of the bonds.

Article 158: Registration and clearing institutions of registered corporate bonds shall establish relevant systems such as systems for registration, keeping custody, payment of interest and exchange of bonds.

Article 159: Corporate bonds may be transferred. The transfer price of corporate bonds shall be agreed upon between the transferor and the transferee.
Where the corporate bonds are listed for trading on the stock exchange, they shall be transferred according to the trading rules of the stock exchange.

Article 160: Registered corporate bonds shall be transferred by means of endorsement by the bondholder or such other means as specified in laws and administrative regulations. After the transfer, the company shall record the name and domicile of the transferee in the corporate bond counterfoil book.
A transfer of bearer corporate bonds shall become effective immediately upon delivery of the bonds by the bondholder to the transferee.

Article 161: Upon adoption of a pertinent resolution by the general meeting, listed companies may issue corporate bonds convertible into shares. The specific method of conversion shall be stipulated in the method of offer of the corporate bonds. Any issuance of corporate bonds convertible into shares by a listed company shall be reported to the State Council's securities regulatory authority for verification and approval.
When issuing corporate bonds convertible into shares, the words "convertible corporate bond" shall be clearly indicated on the bonds, and the amount of convertible corporate bonds shall be recorded in the corporate bond counterfoil book.

Article 162: A company that issues corporate bonds convertible into shares shall issue shares in exchange for such bonds to the bondholders in accordance with the conversion method. However, bondholders shall have an option as to whether or not to convert their bonds into shares.

Chapter VIII: Financial Affairs and Accounting of Companies

Article 163: Companies shall establish their own financial and accounting systems in accordance with laws, administrative regulations, and regulations of the finance department of the State Council.

Article 164: Companies shall prepare financial and accounting reports at the end of each fiscal year. Such reports shall be audited by an accounting firm according to the law.
Financial and accounting reports of companies shall be prepared according to laws, administrative regulations and regulations of the finance department of the State Council.

Article 165: Limited liability companies shall deliver their financial and accounting reports to each of their shareholders within the time limit specified in their articles of association.
The financial and accounting reports of companies limited by shares shall be made available at the company for the perusal of shareholders 20 days before the annual general meeting is held. Companies limited by shares that issue shares to the public shall announce their financial and accounting reports.

Article 166: When companies distribute their after-tax profits for a given year, they shall allocate 10% of profits to their statutory common reserve. Companies shall no longer be required to make allocations to their statutory common reserve once the aggregate amount of such reserve exceeds 50% of their registered capital.
If a company's statutory common reserve is insufficient to make up its losses of the previous years, such losses shall be made up from the profit for the current year prior to making allocations to the statutory common reserve pursuant to the preceding paragraph.
Companies may, if so resolved by the board of shareholders or the general meeting, make allocations to the discretionary common reserve from their after-tax profits after making allocations to the statutory common reserve from the after-tax profits.
A company's after-tax profits remaining after it has made up its losses and made allocations to its common reserve shall be distributed, in the case of a limited liability company, according to Article 35 hereof and, in the case of a company limited by shares, in proportion to the shareholdings of its shareholders, unless the articles of association of the company limited by shares stipulate that the profits shall not be distributed in proportion to the shareholdings.
If the board of shareholders, general meeting or board of directors violates the preceding paragraph by distributing profits to shareholders before the company has made up its losses and made allocations to the statutory common reserve, the profit

distributed in violation of regulations shall be returned to the company by the shareholders.
Companies that hold the shares of their own company shall not be entitled to profit distribution.

Article 167: Companies shall enter under their capital common reserve the premiums earned from the issue of shares above par and such other revenue as the finance department of the State Council requires to be entered under the capital common reserve.

Article 168: Companies shall apply their common reserve to making up their losses, increasing their production and business operations, or increasing their capital by means of conversion. However, the capital common reserve may not be used to make up the losses of the company.
When funds from the statutory common reserve are converted to capital, the funds remaining in such reserve shall amount to not less than 25% of the increased registered capital.

Article 169: The employment and dismissal of accounting firms that handle company's audit business by the companies shall be decided by the board of shareholders, general meeting and board of directors according to the stipulations of the company's articles of association.
When the board of shareholders, general meeting or board of directors votes on the dismissal of accounting firms, it shall permit the accounting firm to state its opinion.

Article 170: Companies shall provide to the accounting firm they employ truthful and complete accounting vouchers, account books, financial and accounting reports and other accounting materials, and may not refuse to do so, or conceal or submit untruthful materials.

Article 171: Companies may not establish any account books in addition to those required by law.
No accounts may be opened in the name of any individual for the keeping of a company's assets.

Chapter IX: Merger and Division, Increase and Reduction of Capital of Companies

Article 172: The merger of companies may take the form of merger by absorption or merger by new establishment.
The absorption by one company of one or more other companies shall be merger by absorption, in which case the absorbed company or companies shall be dissolved.
The merger of two or more companies and establishment of a new company shall be merger by new establishment, in which case the parties to the merger shall be dissolved.

Article 173: When companies merge, the parties to the merger shall enter into a merger agreement and prepare balance sheets and schedules of property. The companies shall notify their creditors within a period of 10 days commencing from the date on which the merger resolution is passed and, within 30 days, make newspaper announcements of the merger. Such creditors may, within a period of 30 days commencing from the date of receipt of the written notification, or within a period of 45 days commencing from the date of the announcement for those who do not receive the written notification, claim full repayment or require the provision of a corresponding guarantee from the company concerned.

Article 174: When companies merge, the surviving company or the newly established company shall succeed to the claims and debts of each party to the merger.

Article 175: When a company is divided, its property shall be divided correspondingly.
When a company is to be divided, it shall prepare a balance sheet and a schedule of property. The company shall notify its creditors within a period of 10 days commencing from the date on which the division resolution is passed and, within 30 days, make newspaper announcement of the division.

Article 176: The joint and several liabilities for the debts existing before a company is divided shall be borne by the companies in existence following the division, except where the written agreement on payment of debts reached between the company and the creditors prior to the division stipulates otherwise.

Article 177: When a company needs to reduce its registered capital, it shall prepare a balance sheet and a schedule of property.
The company shall notify its creditors within a period of 10 days commencing from the date on which the resolution to reduce the registered capital is passed and, within 30 days, make newspaper announcement of the reduction. Such creditors shall, within a period of 30 days commencing from the date of receipt of the written notification, or within a period of 45 days commencing from the date of the announcement for those who do not receive the written notification, have the right to claim full repayment or require the provision of a corresponding guarantee from the company.

Article 178: When a limited liability company increases its registered capital, the capital contributions to the increase in capital subscribed for by its shareholders shall be handled in accordance with the relevant provisions hereof concerning payment of capital contributions in connection with the establishment of a limited liability company.
When a company limited by shares issues new shares to increase its registered capital, shareholders shall subscribe for the new shares in accordance with the relevant provisions hereof concerning the payment of subscription monies in connection with the establishment of a company limited by shares.

Article 179: When companies merge or a company is divided, causing some changes to relevant registered particulars, change of registration shall be handled with the company registration authority in accordance with the law. When a company is dissolved, the cancellation of registration shall be handled in accordance with the law. When a new company is established, its establishment shall be registered according to the law.
When a company increases or reduces its registered capital, it shall register the change with the company registration authority in accordance with the law.

Chapter X: Dissolution and Liquidation of Companies

Article 180: A company shall be dissolved due to the following reasons:

(I) when the term of operation as specified in the company's articles of association expires or another cause of dissolution as specified in the company's articles of association arises;
(II) if the board of shareholders or general meeting resolves to dissolve the company;
(III) if dissolution is necessary as a result of the merger or division of the company;
(IV) its business license has been revoked, or it is ordered to close down or to be revoked according to the law; or
(V) it is ordered to be dissolved by the people's court according to Article 183 hereof.

Article 181: A company under the circumstance stated in Item (I) of Article 180 of the Law may continue to exist by modifying its articles of association.
The modification of the company's articles of association in accordance with the preceding paragraph shall be subject to adoption, in the case of a limited liability company, by the shareholders representing more than two thirds of the voting rights or, in the case of a company limited by shares, by the shareholders that are present at the general meeting of shareholders and represent more than two thirds of the voting rights.

Article 182: Where any severe difficulty occurs to the operation management of a company, in which case the interests of the shareholders may suffer heavy losses if the company continues to exist and there is no other way to solve the problem, the shareholders representing more than ten percent of the voting rights of all the shareholders of the company may file a request with the people's court to dissolve the company.

Article 183: Where a company is dissolved under Item (I), (II), (IV), or (V) of Article 180 of the Law, a liquidation group shall be formed to commence the liquidation within 15 days after a cause of dissolution occurs. The liquidation group shall be composed of shareholders, in the case of a limited liability company; or shall be composed of directors or the candidates determined by the general meeting of shareholders, in the case of a company limited by shares. Where a liquidation

group has not been formed to carry out liquidation within the specified time limit, the creditors may apply to the people's court for its designation of relevant personnel to form a liquidation group and carry out liquidation. The people's court shall accept the application, and shall, in a timely manner, organize a liquidation group to carry out liquidation.

Article 184: The liquidation group may exercise the following powers during liquidation:

(I) to thoroughly examine the property of the company and prepare a balance sheet and a schedule of property respectively;
(II) to notify creditors by notice or announcement;
(III) to dispose of and liquidate relevant unfinished business of the company;
(IV) to pay all outstanding taxes in full as well as taxes arising in the course of liquidation;
(V) to clear the claims and debts;
(VI) to dispose of the property remained after full payment of the company's debts; and
(VII) to participate in civil litigation activities on behalf of the company.

Article 185: A liquidation group shall notify the creditors within a period of 10 days commencing from the date of its establishment and, within 60 days, make newspaper announcement of the liquidation. Such creditors shall, within a period of 30 days commencing from the date of receipt of the written notification, or within a period of 45 days commencing from the date of the announcement for those who do not receive the written notification, declare their claims to the liquidation group.
When declaring their claims, the creditors shall explain relevant particulars of their claims and provide supporting materials. Claims shall be registered by the liquidation group.
During the period of declaration of claims, the liquidation group may not repay the debts to the creditors.

Article 186: After a liquidation group has thoroughly examined the company's property and prepared a balance sheet and a schedule of property, it shall formulate a liquidation plan and submit the same to the board of shareholders, general meeting or the people's court for confirmation.
The property of a company remained after the property is respectively applied to payment of the liquidation expenses, the wages, social insurance premiums and statutory compensation of staff and workers and the outstanding taxes, and to full payment of the debts of the company shall be distributed, in the case of a limited liability company, in proportion to the capital contributions of its shareholders and, in the case of a company limited by shares, in proportion to the shareholdings of its shareholders.
During liquidation, a company shall continue to exist, but it may not engage in new business activities unrelated to liquidation. Company property may not be distributed among its shareholders prior to full repayment in accordance with the stipulations of the preceding paragraph.

Article 187: If the liquidation group, having thoroughly examined the company's property and prepared a balance sheet and a schedule of property, discovers that the company's property is insufficient to pay its debts in full, it shall apply to the people's court for declaration of insolvency according to the law.
After the people's court has ruled to declare the company insolvent, the company's liquidation group shall turn over the liquidation matters to the people's court.

Article 188: Following the completion of liquidation, the liquidation group shall compile a liquidation report and submit the same to the board of shareholders, general meeting or the people's court for confirmation, as well as to the company registration authority. In addition, the liquidation group shall apply for cancellation of the company's registration and announce the company's termination.

Article 189: Members of a liquidation group shall be devoted to their duties and perform their liquidation obligations according to the law.
Members of a liquidation group may not abuse their authority to accept bribes or other illegal income and may not seize company property.
If members of a liquidation group willfully or through gross negligence cause losses to the company or its creditors, they shall be liable for compensation.

Article 190: Where a company is declared bankrupt according to the law, it shall be subject to insolvency liquidation according to the laws on enterprise insolvency.

Chapter XI: Branches of Foreign Companies

Article 191: For the purposes of the Law, the term "foreign companies" refers to companies incorporated outside China in accordance with a foreign country's law.

Article 192: To establish a branch in China, a foreign company shall file an application with China's competent authority and submit relevant documents such as its articles of association, the company registration certificate issued by its country, etc. Upon approval, it shall go through registration procedures with the company registration authority according to the law and obtain a business license.
Measures for examination and approval of branches of foreign companies shall be separately stipulated by the State Council.

Article 193: A foreign company that establishes a branch in China shall designate a representative or an agent in China to be responsible for such branch and shall allocate an amount of funds to such branch commensurate with the business activities in which it is to engage.
If it is necessary to prescribe a minimum amount of operating funds of branches of foreign companies, such amount shall be separately prescribed by the State Council.

Article 194: The name of a branch of a foreign company shall indicate the nationality and form of liability of such foreign company.
The branch of a foreign company shall keep at its office a copy of such foreign company's articles of association.

Article 195: Branches established in China by foreign companies shall not have the status of Chinese legal persons.
Foreign companies shall be civilly liable for the business activities carried out in China by their branches.

Article 196: The business activities engaged in within China by foreign companies' branches that have been established upon approval shall comply with the law of China and may not harm China's social public interests. The lawful rights and interests of such branches shall be protected by the laws of China.

Article 197: When a foreign company closes its branch in China, it shall pay its debts in full according to the law and carry out liquidation in accordance with the provisions of the Law concerning company liquidation procedure. Such foreign company may not transfer its branch's property out of China prior to full payment of its debts.

Chapter XII: Legal Liability

Article 198: If, in violation of the provisions hereof, company registration is obtained by means of reporting a false amount of registered capital or by submitting false materials or resorting to other fraudulent methods to conceal major facts, the company registration authority shall order rectification and, in the case of a company that reported a false amount of registered capital, the company shall be fined not less than 5% and not more than 15% of the false amount of registered capital and, in the case of a company that submitted false materials or resorted to other fraudulent methods to conceal major facts, the company shall be fined not less than RMB 50,000 and not more than RMB 500,000. In serious cases, the company's registration or the business license shall be revoked.

Article 199: If promoters or shareholders of a company make false capital contributions by failing to pay or deliver or pay or deliver according to schedule monetary or non-monetary property as capital contribution, the company registration authority shall order rectification, and a fine of not less than 5% and not more than 15% of the amount of false capital contribution shall be imposed.

Article 200: If promoters or shareholders of a company surreptitiously withdraw their capital contributions after the company has been established, the company registration authority shall order rectification, and a fine of not less than 5% and not more than 15% of the amount of capital contribution withdrawn surreptitiously shall be imposed.

Article 201: If a company violates the Law by establishing account books in addition to those required by law, the finance department of the people's government at county level or above shall order rectification, and a fine of not less than RMB 50,000 and not more than RMB 500,000 shall be imposed.

Article 202: If a company makes false record or conceals major facts in the materials provided to the relevant department in charge such as the financial and

accounting reports, the relevant department in charge shall impose a fine of not less than RMB 30,000 and not more than RMB 300,000 on the personnel in charge that are directly responsible and other directly responsible personnel.

Article 203: If a company fails to make allocations to the statutory common reserve in accordance with the provisions hereof, the finance department of the people's government at county level or above shall order the company to allocate the full amount to be allocated, and may impose a fine of not more than RMB 200,000 on the company.

Article 204: If a company, when being merged or divided, reducing its registered capital or carrying out liquidation, fails to notify its creditors or to announce the same to its creditors in accordance with the provisions hereof, the company registration authority shall order rectification, and the company shall be fined not less than RMB 10,000 and not more than RMB 100,000.

If a company in liquidation conceals its property, records false information in its balance sheet or schedule of property or distributes company property prior to full payment of its debts, the company registration authority shall order rectification, and the company shall be fined not less than 5% and not more than 10% of the amount of property concealed or the amount of company property distributed prior to full repayment of its debts. The personnel in charge that are directly responsible and other directly responsible personnel shall be fined not less than RMB 10,000 and not more than RMB 100,000.

Article 205: If a company, during the period of liquidation, engages in business activities unrelated to liquidation, the company registration authority shall issue a warning and confiscate the illegal income.

Article 206: If a liquidation group fails to submit a liquidation report to the company registration authority in accordance with the provisions hereof or if the liquidation report submitted conceals major facts or contains major omissions, the company registration authority shall order rectification.

If members of a liquidation group use their authority to engage in graft, seek illegal income or seize company property, the company registration authority shall order them to return company property, confiscate the illegal income and may impose a fine of not less than the amount of the illegal income and not more than five times of the illegal income.

Article 207: If an organization undertaking asset valuation, capital verification or other verification provides false materials, the company registration authority shall confiscate its illegal income, impose a fine of not less than the amount of the illegal income and not more than five times of the illegal income, and the relevant departments in charge may order the organization to cease business, revoke the qualification certificates of the personnel directly responsible and revoke the business license according to the law.

If an organization undertaking asset valuation, capital verification or other verification provides a report containing serious omissions due to negligence, the

company registration authority shall order rectification. If the circumstances are relatively serious, it shall be fined not less than the amount of the revenue obtained and not more than five times of the revenue obtained and, in addition, the relevant departments in charge may order the organization to cease business, revoke the qualification certificates of the personnel directly responsible and revoke the business license according to the law.

If the valuation result, certificate of capital verification or other verification issued by an organization undertaking asset valuation, capital verification or other verification is proved to be false, thereby causing losses to the creditors of a company, the organization shall bear the liability for compensation to the extent of the amount of the false valuation or verification unless it is able to prove that it is not at fault.

Article 208: If the company registration authority grants registration to an application for registration that does not satisfy the conditions set forth herein, or does not grant registration to an application for registration that satisfies the conditions set forth herein, administrative sanctions shall be given to the personnel in charge that are directly responsible and other directly responsible personnel according to the law.

Article 209: If the superior authorities of the company registration authority force the company registration authority to grant registration to an application for registration that does not satisfy the conditions set forth herein or not to grant registration to an application for registration that satisfies the conditions set forth herein, or if they cover up an illegal registration, administrative sanctions shall be given to the personnel in charge that are directly responsible and other directly responsible personnel according to the law.

Article 210: If an entity that has not been registered according to the law as a limited liability company or company limited by shares passes itself off as a limited liability company or company limited by shares, or an entity that has not been registered according to the law as the branch of a limited liability company or company limited by shares passes itself off as the branch of a limited liability company or company limited by shares, the company registration authority shall order rectification or close down the entity, and may impose a fine of not more than RMB 100,000.

Article 211: If a company, without proper reason, fails to commence business within six months following its establishment or, after having commenced business, voluntarily suspends business for more than six months, its business license may be revoked by the company registration authority.

If a change occurs in a particular of company registration and the relevant change is not registered in accordance with the provisions hereof, the company registration authority shall order registration within a time limit and, if registration is not carried out within such time limit, a fine of not less than RMB 10,000 and not more than RMB 100,000 shall be imposed.

Article 212: If a foreign company violates the provisions hereof by establishing a branch in China without authorization, the company registration authority shall order rectification or shut down the branch, and may impose a fine of not less than RMB 50,000 and not more than RMB 200,000.

Article 213: If serious illegal acts that harm State security and social and public interests are carried out in the name of the company, the business license shall be revoked.

Article 214: Companies that violate the provisions hereof shall assume civil liability for compensation and be subject to fines, and in case that such company's property is insufficient to pay such compensation and fine, it shall first assume civil liability for compensation.

Article 215: Where the provisions hereof are violated and a crime is constituted, such crime shall be subject to criminal prosecution according to the law.

Chapter XIII: Supplementary Provisions

Article 216: The meanings of the following terms in the Law are defined as follows:

(I) "senior officers" refer to the manager, deputy manager and person in charge of financial affairs of a company and, in the case of a listed company, the secretary to the board of directors and other personnel specified in the articles of association.

(II) "controlling shareholder" refers to the shareholder whose capital contribution accounts for 50% or more of the total capital of a limited liability company or whose shareholding accounts for 50% or more of the total share capital of a company limited by shares; or the shareholder whose capital contribution or shareholding is less than 50% but whose voting rights pursuant to such capital contribution or shareholding are sufficient to have a major impact on the resolutions of the board of shareholders or general meeting.

(III) "de facto controller" refers to a person who, although is not a shareholder of the company, is capable of actually controlling the conduct of the company through investment relations, agreements or other arrangements.

(IV) "affiliation" refers to the relationship between the controlling shareholder, de facto controller, director, supervisor or senior officers of a company and an enterprise directly or indirectly controlled by him as well as any other relationship that may lead to a transfer of the interests of the company. However, there shall be no affiliation between State-controlled enterprises merely due to the fact that the State has a controlling interest in them.

Article 217: The Law shall apply to foreign-funded limited liability companies and companies limited by shares. Where laws on foreign investment have other stipulations, such stipulations shall apply.

Article 218: The Law shall come into force as of January 1, 2006.

PRC DRAFT FOREIGN INVESTMENT LAW[1]

Chapter 1: General Provisions
Chapter 2: Foreign Investors and Foreign Investment
Chapter 3: Market Access Administration
Chapter 4: National Security Review
Chapter 5: Information Reporting
Chapter 6: Investment Promotion
Chapter 7: Investment Protection
Chapter 8: Coordination and Complaint Settlement
Chapter 9: Supervision and Inspection
Chapter 10: Legal Liabilities
Chapter 11: Supplementary Provisions

Chapter 1: General Provisions

Article 1 [Legislative purpose]
This law is formulated for the purpose of expanding and opening the domestic market, promoting and regulating foreign investment, protecting the legal rights of foreign investors, safeguarding national security and social-public interests, and accelerating the healthy development of a socialist market economy.

Article 2 [Scope of application]
This Law shall apply to investments made in Mainland China by foreign investors.

Article 3 [Investment protection]
The State protects the legitimate rights and interests of foreign investors and foreign invested enterprises in accordance with the law.

Article 4 [Compliance with domestic laws]
Foreign investors and foreign-invested enterprises shall comply with Chinese laws, and shall not undermine China's national security and public interests.
When making investment and engaging in business activities, foreign investors and foreign-invested enterprises shall abide by social ethics and business ethics, uphold honesty and trustworthiness, accept public supervision, and assume social responsibilities.

Article 5 [Foreign investment management regime]
The State adopts a unified foreign investment management regime.

Article 6 [National treatment]
Foreign investors shall enjoy national treatment when investing in Mainland China, unless otherwise prescribed by the Catalogue of Special Management Measures for foreign investment (hereinafter referred to as the "Catalogue of Special

[1] This translation of the Draft is a courtesy of American Chamber of Commerce and European Chamber.

Management Measures") formulated pursuant to Article 23 [Procedures for Catalogue Formulation] herein.

Article 7 [Investment promotion]
The State shall formulate and adopt foreign investment promotion policies in accordance with the socialist market economy, promote investment facilitation, and establish and improve a market system that is unified, open, competitive and orderly.

Article 8 [Principle of openness and transparency]
The State shall manage the investment in Mainland China by foreign investors in an open and transparent manner.

Article 9 [Competent foreign investment departments]
The competent foreign investment department of the State Council shall be in charge of foreign investment management and promotion at the national level in accordance with this Law.
Competent foreign investment departments of local people's governments at and above the county level shall be in charge of foreign investment management and promotion work within their respective jurisdictions according to statutory authority.

Article 10 [Investment treaties]
The State shall, according to the principle of equality and mutual benefit, promote and develop investment with other countries and regions, and conclude bilateral, multilateral and regional investment treaties, conventions and agreements.

Chapter 2: Foreign Investors and Foreign Investment

Article 11 [Foreign investors]
For the purpose of this Law, foreign investors shall refer to the following parties that invest in Mainland China:

(1) Natural persons who do not hold Chinese nationality;
(2) Enterprises established pursuant to the laws of other countries or regions;
(3) Governments of other countries or regions and their subordinate departments or agencies; and
(4) International organizations.

Domestic enterprises controlled by any of the parties prescribed under the preceding Paragraph shall be deemed as foreign investors.

Article 12 [Chinese investors]
For the purpose of this Law, the term "Chinese investors" shall refer to the following parties:

(1) Natural persons of Chinese nationality;
(2) The Chinese Government and its subordinate departments or agencies; and

(3) Domestic enterprises controlled by any of the parties under the preceding two items.

Article 13 [Domestic enterprises]
For the purpose of this Law, the term "domestic enterprises" shall refer to enterprises established in Mainland China pursuant to Chinese laws.

Article 14 [Foreign-invested enterprises]
For the purpose of this Law, the term "foreign-invested enterprises" shall refer to enterprises established in Mainland China pursuant to Chinese laws that are solely or partially invested by foreign investors.

Article 15 [Foreign investment]
For the purpose of this Law, the term "foreign investment" shall refer to any of the following investment activities directly or indirectly carried out by a foreign investor:

(1) To establish a domestic enterprise;
(2) To acquire the shares, equities, property shares, voting rights or other similar rights and interests of a domestic enterprise;
(3) To provide financing of one year or longer for a domestic enterprise in which the foreign investor holds any of the rights and interests as prescribed by the preceding Item;
(4) To obtain concession rights for natural resources exploration or exploitation in the Mainland or other areas subject to China's resource jurisdiction, or to obtain concession rights for infrastructure construction or operations;
(5) To obtain the right to use domestic land, the ownership of domestic properties and other domestic real estate rights; or
(6) To control a domestic enterprise or hold the rights and interests of a domestic enterprise through contracts, trusts and other means.

Overseas transactions that result in the transfer of the actual control over a domestic enterprise to a foreign investor shall be deemed as investment in Mainland China by the foreign investor.

Article 16 [Real estate rights]
Where a foreign investor obtains the right to use domestic land, the ownership of domestic properties and other domestic real estate rights, relevant laws and regulations, as well as the provisions of Chapter 4 [National Security Review] and Chapter 5 [Information Reporting] herein shall apply.

Article 17 [Non-profit organizations]
Where a foreign investor sets up a non-profit organization or obtains the rights and interests of a non-profit organization in Mainland China, relevant laws and regulations, as well as the provisions of Chapter 4 [National Security Review] and Chapter 5 [Information Reporting] of this Law shall apply.

Article 18 [Control]
For the purpose of this Law, a party shall have control over an enterprise when it meets any of the following circumstances:

(1) Where the party directly or indirectly holds 50% or more of the shares, equity, property shares, voting rights or other similar rights and interests of the subject enterprise;
(2) Where the party directly or indirectly holding less than 50% of the shares, equity, property shares, voting rights or other similar rights and interests of the subject enterprise, but falls under any of the following circumstances:

    1. The party is entitled to, directly or indirectly, appoint at least half of the members of the board of directors or a similar decision-making body of the subject enterprise;
    2. The party has the ability to ensure that its nominated persons can obtain at least half of the seats on the board of directors or a similar decision-making body of the subject enterprise; or
    3. The voting rights to which the party is entitled are sufficient to exert a material impact on the resolutions of the shareholders' meeting, the general meeting, the board of directors or other decision-making bodies of the enterprise. or

(3) Where the party is able to exert a decisive influence on the operations, finance, personnel, technology, etc. of the subject enterprise through contracts, trust or other means.

Article 19 [Actual controller]
For the purpose of this Law, the term "actual controllers" shall refer to natural persons or enterprises that directly or indirectly control foreign investors or foreign invested enterprises.

Chapter 3: Market Access Administration

Section 1: General Provisions

Article 20 [Foreign investment market access regime]
The State shall adopt a unified foreign investment market access regime, and manage fields in which foreign investment is prohibited or restricted pursuant to the Catalogue of Special Management Measures.

Article 21 [Competent department in charge of foreign investment market access]
The competent foreign investment department shall manage the market access of foreign investment in conjunction with other relevant departments.

Article 22 [Catalogue of Special Management Measures]
Where foreign investors and their investments are to be given treatment less favorable than that granted to Chinese investors and their investments or are to be

subject to other restrictions, such treatment or restrictions shall be prescribed in the form of laws, administrative regulations or decisions of the State Council, and be included in the Catalogue of Special Management Measures.

Article 23 [Procedures for catalogue formulation]
The Catalogue of Special Management Measures shall be formulated and promulgated by the State Council in a unified manner.
The competent foreign investment department of the State Council shall, in conjunction with other relevant departments and pursuant to the bilateral, multilateral and regional investment treaties, conventions and agreements concluded by the State, as well as relevant laws, administrative regulations and decisions of the State Council on foreign investment, raise suggestions on formulating or adjusting the Catalogue of Special Management Measures, and submit these suggestions to the State Council for deliberation.

Article 24 [Catalogue classification]
The Catalogue of Special Management Measures shall be divided into a list of prohibited investment and a list of restricted investment.
The list of restricted investment shall detail the restrictive conditions on foreign investment.

Article 25 [List of prohibited investment]
Foreign investors are not allowed to invest in the fields specified in the list of prohibited investment.
Where a foreign investor directly or indirectly holds the shares, equity, property shares or other rights and interests, or voting rights of a domestic enterprise, the domestic enterprise shall not invest in the fields specified in the list of prohibited investment, unless otherwise prescribed by the State Council.

Article 26 [List of restricted investment]
The list of restricted investment shall include the following scenarios:

(1) Investments exceeding the relevant monetary thresholds prescribed by the State Council; and
(2) Fields in which foreign investment is restricted.

A foreign investor who falls under any of the scenarios specified in the list of restricted investment shall satisfy the conditions prescribed in the list of restricted investment, and shall apply for market access licensing of foreign investment to the competent foreign investment department in accordance with this Law.
Foreign investors are not required to apply for market access licensing for investments not specified in the list of restricted investment.

Section 2: Market Access Licensing

Article 27 [Applying for foreign investment market access licensing]
A foreign investor that intends to make investment under Item (1) of Paragraph 1 of Article 26 [List of restricted investment] herein shall apply for market access licensing to the competent foreign investment department of the State Council.

A foreign investor that intends to make investment under Item (2) of Paragraph 1 of Article 26 [List of restricted investment] herein shall apply for market access licensing to the competent foreign investment department of the State Council or the competent foreign investment department of the people's government of the relevant province, autonomous region or centrally-administered municipality. Specific division of the licensing authority shall be prescribed by the State Council.

Article 28 [Cumulative calculation of the investment amount]
A foreign investor shall apply for market access licensing in accordance with this Law if it repeatedly invests in the same investment item within two years and the cumulative amount of investment reaches the threshold prescribed in the list of restricted investment.

Article 29 [Including financing in the investment amount]
Where a foreign investor directly or indirectly provides financing of one year or longer for a domestic enterprise in which it holds rights and interests, the amount of financing provided shall be included in the amount of investment for calculation.

Article 30 [Application materials for market access licensing]
A foreign investor shall submit the following materials when applying for market access licensing to the competent foreign investment department in accordance with Article 27 [Applying for foreign investment market access licensing] herein:

(1) A written application, covering:

1. The profiles of the foreign investor and the actual controller thereof;
2. Basic information on the proposed foreign investment, including the amount, fields and geographical areas of the investment, investment methods, percentages and methods of capital contribution, etc.;
3. Statements that the proposed foreign investment meets the requirements of special management measures;
4. The impact of the proposed foreign investment on energy resources, technological innovation, employment, environmental protection, production safety, regional development, capital account management and industrial development;
5. Statements on whether the proposed foreign investment triggers national security review and anti-monopoly review;
6. Licensing certificates issued by competent industry departments, applicable where prior industry licensing is required;
7. Information on the organizational form, governance structure, etc. of a foreign invested enterprise, applicable where establishment or modification of the subject foreign-invested enterprise is involved; and
8. Methods of notification and correspondence.

(2) Documents and supporting materials related to the contents of the written application; and
(3) Statements and declarations of the foreign investor and the actual controller thereof, and their declaration on the authenticity and completeness of the application materials.

The competent foreign investment department may require the foreign investor to submit supplementary materials related to the contents prescribed in the preceding Paragraph.

Article 31 [Application acceptance]
Where the application materials submitted by an applicant are complete and in the statutory form, the relevant competent foreign investment department shall accept the market access licensing application, and issue an acknowledgement of application acceptance to the applicant.
Where the application materials are incomplete or are not in the statutory form, the competent foreign investment department shall inform the applicant, on the spot or within five working days, of all the materials to be supplemented/corrected at one time, failing which, the said department shall be deemed to have accepted the application from the date of receipt of the application materials.

Article 32 [Factors subject to review]
A competent foreign investment department shall conduct market access review of the proposed foreign investment by a foreign investor from the following perspectives:

(1) Its impact on national security;
(2) Whether it satisfies the conditions specified in the Catalogue of Special Management Measures;
(3) Its impact on energy resources, technological innovation, employment, environmental protection, production safety, regional development, capital account management, competition, social and public interests, etc.;
(4) Its actual impact on, and control over industry development;
(5) International treaty obligations;
(6) The profiles of the foreign investor and the actual controller thereof; and
(7) Other factors prescribed by the State Council.

Article 33 [Relationship between market access licensing and industry licensing]
Where a proposed foreign investment involves fields subject to prior industry licensing, the competent foreign investment department shall state the situations concerning the approval of industry licensing in its review decision.
Where a proposed foreign investment involves fields subject to non-prior industry licensing, the competent foreign investment department shall consult relevant competent industry departments at the time of review. The competent industry departments shall issue written review comments, which shall be stated by the competent foreign investment department in its review decision.

Article 34 [Connection between market access licensing and national security review]
Where a competent foreign investment department finds that matters of foreign investment endanger or may endanger national security during market access licensing, it shall suspend the market access review process and notify the relevant applicant in writing to submit an application for national security review. The competent foreign investment department of the people's government of the relevant province, autonomous region or centrally-administered municipality which conducts market access review shall report relevant information to the competent foreign investment department of the State Council. Unless the applicant withdraws its application for market access licensing, the foreign investor concerned shall submit an application for national security review pursuant to Chapter 4 [National Security Review] herein.

Article 35 [Review period]
The competent foreign investment department shall complete review within 30 working days upon the date of acceptance of an application for market access licensing. The review period may be extended by another 30 working days under complicated circumstances.
Where the procedures for national security review are activated under the circumstances prescribed by Article 34 [Connection between market access licensing and national security review] herein, the period for national security review shall not be included in the review period prescribed in the preceding Paragraph.

Article 36 [Review decision]
The competent foreign investment department shall, pursuant to the law, make a written decision on approval, conditional approval or rejection of foreign investment matters, and notify the applicant concerned of the said decision. The said department shall explain relevant reasons if it makes a decision on conditional approval or rejection.

Article 37 [Types of additional conditions]
The competent foreign investment department may attach one or more of the following conditions to a review decision:

(1) Divestment of assets or business;
(2) Limits on the percentages of shareholding;
(3) Requirements on the operating period;
(4) Restrictions on investment regions;
(5) Requirements on the percentage or number of local employment; and/or
(6) Other conditions prescribed by the State Council.

The competent foreign investment department shall list one or more of the aforesaid conditions in its review decision if such conditions are to be attached.

Article 38 [Soliciting opinions]
When conducting market access review, the competent foreign investment department may consult relevant departments, regions and other stakeholders.

Article 39 [Soliciting public opinions]
When conducting market access review, the competent foreign investment department may solicit public opinions by holding panel discussions or public hearings if it considers that the matters under application may have a significant impact on public interests.

Article 40 [Opportunity for self-defense]
Where the competent foreign investment department intends to make a decision on conditional approval or non-approval during market access review, it shall give the foreign investor concerned the opportunity to defend its position.

Article 41 [Validity period of an approval decision]
A foreign investor that fails to make the relevant investment within one year from the date of the approval decision shall explain relevant situations to the competent foreign investment department that has made the approval decision. Where the competent foreign investment department deems it necessary, the foreign investor shall submit a new application for market access licensing.

Article 42 [Handling formalities]
Where a proposed foreign investment is subject to market access licensing in accordance with this Law, the foreign investor concerned shall go through the procedures for registration, foreign exchange administration, taxation, etc. after obtaining market access licensing.
Where a proposed foreign investment is not subject to market access licensing in accordance with this Law, the foreign investor concerned may go through the procedures for registration, foreign exchange administration, taxation, etc. in accordance with relevant laws and regulations.

Article 43 [Disclosure of licensing decisions]
The competent foreign investment department shall make public its market access licensing decisions on foreign investment, unless such decisions shall not be disclosed in accordance with the law.

Article 44 [Reports on compliance with additional conditions]
Where market access licensing is granted to a foreign investment with additional conditions attached in accordance with this Law, the relevant foreign investor or foreign-invested enterprise shall, at the same time of submitting an annual report pursuant to Section 4 [Periodic Reports] of Chapter 5 [Information Reporting] herein, explain the situations on conducting business operations in the preceding year in compliance with the additional conditions attached.

Article 45 [Circumstances of actual control deemed as domestic investment]
Where a foreign investor prescribed by Item (2) of Paragraph 1 of Article 11 [Foreign investors] herein is controlled by a Chinese investor, the foreign investor may, when applying for market access licensing for its investment in Mainland China that is included in the scope of the list of restricted investment, submit supporting materials in writing to apply for having its investment deemed as investment by the said Chinese investor.

The relevant competent foreign investment department shall, when conducting market access licensing review, review the application submitted by the foreign investor in accordance with the preceding Paragraph, issue review opinions on whether to deem the investment as investment by the Chinese investor, and explain the same in its market access licensing decision.

Article 46 [Guidelines for market access review of foreign investment]
The competent foreign investment department of the State Council shall prepare and publish guidelines for market access review of foreign investment.

Article 47 [Inquiry]
A foreign investor and its interested parties may make inquiries on the scope and procedures of foreign investment market access licensing to the competent foreign investment department prescribed by Article 27 [Applying for foreign investment market access licensing] herein.
The competent foreign investment department shall reply within 10 working days upon receipt of the inquiry application.

Chapter 4: National Security Review

Article 48 [National security review regime]
With a view to ensuring national security, and regulating and promoting foreign investment, the State shall establish a unified foreign investment national security review regime to review any foreign investment that endangers or may endanger national security.

Article 49 [Joint conference for national security review]
The State Council shall establish an inter-ministerial joint conference for foreign investment national security review (hereinafter referred to as the "Joint Conference") to assume the responsibilities for national security review of foreign investment.
The development and reform department and the competent foreign investment department of the State Council shall serve as co-conveners of the Joint Conference, and shall work together with relevant departments involved in foreign investment to conduct specific national security review of foreign investment.

Article 50 [Applying for national security review by investors]
Where a proposed foreign investment endangers or may endanger national security, the foreign investor concerned may submit an application to the competent foreign investment department of the State Council for national security review.

Article 51 [Application materials for national security review]
A foreign investor shall submit the following materials when applying for national security review to the competent foreign investment department of the State Council:

(1) A written application, covering:

    1. The profiles of the foreign investor and the actual controller and senior management personnel thereof;
    2. Basic information on the proposed foreign investment, including the amount, fields and geographical areas of the investment, investment methods, percentages and methods of capital contribution, business plans, etc.;
    3. Statements that the proposed foreign investment endangers or may endanger national security;
    4. Information on the organizational form, governance structure, etc. of a foreign invested enterprise, applicable where the establishment or modification of the foreign-invested enterprise is involved; and
    5. Methods of notification and correspondence.

(2) Documents and supporting materials related to the contents of the written application; and
(3) Statements and declarations of the foreign investor and the actual controller thereof, and their declaration on the authenticity and completeness of the application materials.

The competent foreign investment department of the State Council may require the foreign investor and other parties concerned to submit relevant supplementary materials during the process of national security review.

Article 52 [Making appointments for discussion]
Prior to applying for national security review to the competent foreign investment department of the State Council, a foreign investor may request to make an appointment to discuss relevant procedural issues and communicate relevant situations in advance.

Article 53 [Determining whether to proceed with national security review]
The competent foreign investment department of the State Council shall, within 15 working days upon receipt of the application materials prescribed by Article 51 [Application materials for national security review] herein, inform the applicant of whether national security review is needed for the foreign investment concerned.
Where national security review is necessary, the competent foreign investment department of the State Council shall request the Joint Conference to conduct review within 5 working days upon informing the applicant of relevant situations.

Article 54 [Withdrawing national security review applications by investors]
After submitting an application for national security review, a foreign investor shall not withdraw the said application without the consent of the competent foreign investment department of the State Council.

Article 55 [Commencing national security review ex officio]
The Joint Conference may decide, ex officio, to conduct national security review of foreign investment that endangers or may endanger national security.

Where relevant departments, industrial associations, enterprises in the same industry, upstream and downstream enterprises and parties concerned other than the relevant foreign investor itself are of the opinion that national security review is needed for a certain foreign investment, they may raise suggestions on conducting national security review to the competent foreign investment department of the State Council.

The Joint Conference may decide to conduct national security review if it deems such review as genuinely necessary.

Where the Joint Conference decides to commence national security review, the competent foreign investment department of the State Council shall inform the foreign investor concerned in writing.

Article 56 [Re-conducting national security review]

Under any of the following circumstances, the Joint Conference may, pursuant to Article 55 [Commencing national security review ex officio] herein, conduct another round of national security review of a foreign investment that has already been reviewed:

(1) Where the relevant foreign investor or other parties concerned have concealed relevant situations, provided false materials or made false statements during the original review; or
(2) Where the relevant foreign investor or other parties concerned have made the investment in breach of the restrictive conditions attached to the original review decision.

Article 57 [Factors subject to national security review]

Factors that shall be considered during the national security review of a proposed foreign investment include:

(1) Its impact on national defense security, including the impact on the capacity for producing domestic products and providing domestic services needed for national defense, the impact on relevant equipment and facilities needed for national defense, and the impact on the safety of key and sensitive national defense installations;
(2) Its impact on the research and development ("R&D") capacity of key technologies involving national security;
(3) Its impact on China's technological leadership in fields involving national security;
(4) Its impact on the proliferation of dual-use items and technologies subject to import and export control;
(5) Its impact on China's critical infrastructure and key technologies;
(6) Its impact on China's information and network security;
(7) Its impact on China's long-term demand in terms of energy, grains and other critical resources;
(8) Whether matters of the proposed foreign investment are controlled by a foreign government;

(9) Its impact on the stable operation of the national economy;
(10) Its impact on public interests and the public order; and
(11) Other factors necessary to be considered in the opinion of the Joint Conference.

Article 58 [Types of national security review decisions]
According to the results of national security review of a proposed foreign investment, the State Council or the Joint Conference may make any of the following decisions:

(1) The proposed foreign investment shall be approved if it does not endanger national security;
(2) The proposed foreign investment shall be conditionally approved if it endangers or may endanger national security, but such danger can be eliminated by attaching additional restrictive conditions; or
(3) The proposed foreign investment shall not be approved if it endangers or may endanger national security, and such danger cannot be eliminated.

Article 59 [Obligations to cooperate with national security review]
The foreign investor and other parties concerned shall cooperate with the Joint Conference during national security review, provide information needed for the review, and accept relevant inquiries or verification.

Article 60 [Stages of national security review]
National security review conducted by the Joint Conference shall be divided into the a stage of general review and a stage of special review.

Article 61 [General review period]
General review shall be completed within 30 working days upon the date when the competent foreign investment department of the State Council requests the Joint Conference to conduct review pursuant to Article 53 [Determining whether to proceed with national security review] herein or upon the date when the Joint Conference decides to conduct national security review pursuant to Article 55 [Commencing national security review ex officio] herein.

Article 62 [General review opinions]
After general review, if the Joint Conference is of the opinion that a proposed foreign investment is not detrimental to national security, it shall form review opinions and notify the competent foreign investment department of the State Council in writing; and, if the Joint Conference is of the opinion that the proposed foreign investment may run the risks of endangering national security, it shall decide to conduct special review, and notify the competent foreign investment department of the State Council in writing.
The competent foreign investment department of the State Council shall notify the relevant applicant and parties concerned in writing within 5 working days upon receipt of the review opinions from the Joint Conference.

Article 63 [Special review period]
Special review shall be completed within 60 working days upon the date of activation of the special review process under Article 62 [General review opinions] herein.
Once the special review is activated, the Joint Conference shall organize security assessment of the proposed foreign investment, and conduct review in light of assessment opinions.

Article 64 [Special review opinions]
After special review, if the Joint Conference is of the opinion that a proposed foreign investment is not detrimental to national security, it shall issue written review opinions and notify the competent foreign investment department of the State Council in writing, and the latter shall notify the relevant applicant and parties concerned in writing within 5 working days upon receipt of the review opinions from the Joint Conference.
During special review, if the Joint Conference is of the opinion that the proposed foreign investment endangers or may endanger national security, it shall issue written review opinions and submit the same to the State Council for decision. Where the proposed foreign investment is approved, the competent foreign investment department of the State Council shall notify the relevant applicant and parties concerned in writing; and, where the proposed foreign investment is vetoed, the State Council shall make the veto decision.

Article 65 [Attaching additional restrictive conditions]
To avoid the danger that a proposed foreign investment may impose on national security, the applicant concerned may raise suggestions to the competent foreign investment department of the State Council on attaching additional restrictive conditions to the proposed foreign investment before a review decision is made.
The Joint Conference shall evaluate the effectiveness and feasibility of such suggestions.
The Joint Conference may negotiate and agree with the parties concerned on the additional restrictive conditions to be attached based on evaluation results, including necessary adjustments to the proposed investment, so as to eliminate the possible danger to national security.

Article 66 [Conditional approval]
After conducting evaluation and reaching agreements with the parties concerned, the Joint Conference may make a decision to conditionally approve a proposed foreign investment, and shall notify the competent foreign investment department of the State Council in writing to inform the relevant applicant and parties concerned.

Article 67 [Supervision and implementation of additional conditions]
Where a foreign investment passes national security review with additional restrictive conditions attached in accordance with this Law, the relevant foreign investor or foreign-invested enterprise shall, at the same time of submitting an annual report pursuant to Section 4 [Periodic Reports] of Chapter 5 [Information

Reporting] herein, explain its compliance with the additional restrictive conditions attached in the preceding year.

The competent foreign investment department of the State Council shall, in conjunction with relevant departments, take appropriate measures to supervise the implementation of restrictive conditions. Where the party concerned breaches the restrictive conditions, and thus causes or may cause harm to national security, the competent foreign investment department of the State Council may request for another round of national security review pursuant to Article 56 [Re-conducting national security review] herein.

Article 68 [Guidelines for national security review]

The competent foreign investment department of the State Council shall prepare and publish guidelines for national security review of foreign investment.

Article 69 [Annual reports on national security review]

The competent foreign investment department of the State Council shall prepare and publish annual reports on national security review of foreign investment.

Article 70 [Interim measures for national security review]

During national security review, the competent foreign investment department of the State Council may take necessary interim measures to safeguard national security.

Article 71 [Compulsory measures for national security review]

Where it is found after national security review that a foreign investment has caused or may cause significant harm to national security, the competent foreign investment department of the State Council shall order the parties concerned to refrain from or terminate the foreign investment, or to transfer relevant equities or assets, or to take other effective measures to eliminate or avoid the danger of the foreign investment on national security.

The competent foreign investment department of the State Council may take necessary measures in conjunction with relevant departments to eliminate or avoid the danger of foreign investment on national security.

Article 72 [Assumption of legal liabilities]

Where a foreign investor makes investment without applying for national security review, the losses to the investment caused by the measures taken by the competent foreign investment department of the State Council in accordance with Article 70 [Interim measures for national security review] or Article 71 [Compulsory measures for national security review] herein shall be borne by the foreign investor.

Article 73 [Exemption from administrative reconsideration and litigation]

No administrative reconsideration application and administrative lawsuit may be filed against national security review decisions made in accordance with this Chapter.

Article 74 [Security review regime for foreign investment in the financial sector]
The national security review regime for investment in the financial sector made by foreign investors shall be separately prescribed by the State Council.

Chapter 5: Information Reporting

Section 1: General Provisions

Article 75 [Information reporting regime]
The State shall establish and improve the foreign investment information reporting regime, so as to have a timely, accurate and complete grasp of the situations of foreign investment and the operating conditions of foreign-invested enterprises nationwide, and provide bases for formulating and fine-tuning foreign investment laws, regulations and policies, and promoting and guiding foreign investment.

Article 76 [Information reporting management]
The competent foreign investment department of the State Council shall establish a foreign investment information reporting system, develop information reporting management systems, and be responsible for the summarization, analysis, publication and external exchange of foreign investment information at the national level.

Article 77 [Foreign investment analysis reports]
The competent foreign investment department of the State Council shall prepare and publish annual foreign investment analysis reports covering industry analysis, economic benefits, social impact, policy recommendations, etc. concerning foreign investment.

Article 78 [Parties subject to information reporting]
Foreign investors and foreign-invested enterprises shall fulfill information reporting obligations in accordance with this Law.

Article 79 [Information reporting channels]
Foreign investors and foreign-invested enterprises shall report information to competent foreign investment departments via the foreign investment information reporting regime.

Article 80 [Truthful reporting]
Foreign investors and foreign-invested enterprises shall provide information in a truthful, accurate and complete manner in accordance with this Law. The information provided shall not contain any false records, misleading statements or material omissions.

Article 81 [Reports on portfolio investments]
A foreign investor that purchases the shares of a domestically-listed company shall fulfill reporting, announcement and other statutory obligations pursuant to the Securities Law and relevant provisions of the securities regulatory authority of the State Council.

A foreign investor that purchases 10% or more of the shares of a domestically-listed company, or that causes changes to the control of a domestically-listed company despite only purchasing less than 10% of its shares shall fulfill reporting obligations in accordance with this Chapter.
A foreign investor that purchases less than 10% of the shares of a domestically-listed company and that does not cause changes to the control thereof shall fulfill reporting obligations in accordance with Article 93 [Contents of annual reports—portfolio investments] herein.

Article 82 [Public disclosure of reported information]
The competent foreign investment department of the State Council may, via the foreign investment information reporting system, make public the information provided by foreign investors and foreign-invested enterprises.

Article 83 [Inquiry of reported information]
Citizens, legal persons or other organizations may apply to competent foreign investment departments for inquiring about foreign investment information pursuant to the law.

Article 84 [Exception to information disclosure]
Foreign investment information that involves the trade secrets or personal privacy of foreign investors and foreign-invested enterprises shall not be disclosed, unless otherwise prescribed by laws and administrative regulations.

Section 2: Reporting of Foreign Investment Matters

Article 85 [Time of information reporting]
A foreign investor or foreign-invested enterprise shall submit information reports in accordance with this Section prior to the investment or within 30 days from the date of investment.
Where a foreign investment is subject to registration pursuant to laws and regulations, the date of completion of the appropriate registration shall be the date of investment.
Where a foreign investment is not subject to any registration requirements, the date of completion of the investment transaction shall be the date of investment.

Article 86 [Reports on changes in actual investment]
Where a foreign investor submits information reports prior to the investment, and the actual investment situations subsequently undergo changes, the foreign investor shall report such changes within 30 days from the date of investment.

Article 87 [Contents subject to information reporting]
Where the investment in Mainland China by a foreign investor involves the establishment or change of a foreign-invested enterprise, the foreign-invested enterprise shall report the following information:

(1) The profile of the foreign investor, including its name, domicile, place of registration, actual controller, organizational form, core business, contact persons and contact details;

(2) Basic information on the foreign investment, including the amount, fields and geographical areas of the investment, places of investment sources, investment time and methods, percentages and methods of capital contribution, and information on obtaining relevant administrative licensing or record-filing; and
(3) The profile of the foreign-invested enterprise, including its name, domicile, organizational code, place of registration, equity structure, amount of investment, registered capital, actual controller, organizational form, business scope, contact persons and contact details.

Where the investment in Mainland China by a foreign investor does not involve the establishment or change of a foreign-invested enterprise, only contents prescribed by Item (1) and Item (2) of the preceding Paragraph need to be reported.
The relevant competent foreign investment department may require the foreign investor or the foreign-invested enterprise to make supplementary submissions of materials related to the information prescribed in the preceding two paragraphs.

Article 88 [Reporting on market access licensing]
Where a foreign investment is subject to market access licensing in accordance with this Law, the relevant foreign investor shall fulfill reporting obligations within 30 days after obtaining the market access licensing. In addition to reporting relevant information in accordance with Article 87 [Contents subject to information reporting] herein, the foreign investor shall also report situations on obtaining the market access licensing.

Section 3: Reporting of Changes in Foreign Investment Matters

Article 89 [Changes subject to reporting]
In the event of changes to foreign investment matters, a foreign investor or foreign invested enterprise shall submit reports on such changes within 30 days after the occurrence of the changes.
For the purpose of the preceding Paragraph, changes shall include:

(1) Changes of the name, domicile, place of registration, actual controller, organizational form, core business, contact persons and contact details of the foreign investor;
(2) Changes of the identity of the foreign investor due to merger, division, bankruptcy, dissolution, cancellation, revocation, deregistration or change of nationality, or death;
(3) Changes of the amount, fields or geographical areas of the foreign investment, places of investment sources, investment time or methods, percentages or methods of capital contribution, or information on obtaining relevant administrative licensing or record filing of the foreign investment;
(4) Where the rights and interests of foreign investment are transferred, leased, mortgaged or pledged;
(5) Changes of the name, domicile, organizational code, place of registration, equity structure, amount of investment, registered capital, actual controller,

organizational form, business scope, contact persons and contact details of the foreign-invested enterprise; or
(6) Changes of the status of the foreign-invested enterprise due to merger, division, bankruptcy, dissolution, cancellation, revocation or deregistration.

The relevant competent foreign investment department may require the foreign investor or the foreign-invested enterprise to make supplementary submissions of materials related to the information prescribed in the preceding Paragraph.

Article 90 [Triggering new market access licensing requirements]
Where a foreign investor experiences any of the changes prescribed by Article 89 [Changes subject to reporting] herein, which triggers new market access licensing requirements on foreign investment, the foreign investor shall apply for market access licensing in accordance with this Law.

Article 91 [Breaching conditions for market access licensing]
Where a foreign investor experiences any of the changes prescribed by Article 89 [Changes subject to reporting] herein, which may result in violation of the conditions attached to market access licensing of its foreign investment, the foreign investor shall provide explanations at the same time of submitting the report on changes, and propose solutions. The competent foreign investment department that grants the market access licensing may conduct investigation depending on actual circumstances, and may, where necessary, require the foreign investor to take remedial measures or re-apply for market access licensing pursuant to this Law.

Section 4: Periodic Reports

Article 92 [Contents of an annual report]
Where the investment in Mainland China by a foreign investor involves the establishment or change of a foreign-invested enterprise, the foreign-invested enterprise shall, by April 30 each year, submit its information report of the preceding year which shall cover the following aspects:

(1) The profile of the foreign investor, including its name, domicile, place of registration, actual controller, organizational form, core business, contact persons and contact details;
(2) Basic information on the foreign investment, including the amount, fields and geographical areas of the investment, places of investment sources, investment time and methods, percentages and methods of capital contribution, and information on obtaining relevant administrative licensing or record-filing;
(3) The profile of the foreign-invested enterprise, including its name, domicile, organizational code, place of registration, equity structure, amount of investment, registered capital, actual controller, organizational form, business scope, contact persons and contact details;
(4) Information on the business conditions of the foreign-invested enterprise in the preceding year, including industry fields, main products or services, import and export, employment situations, tax payment, R&D, etc.;

(5) Financial and accounting information of the foreign-invested enterprise in the preceding year, including assets, liabilities, owner's equity, revenue, expenses, profits, etc.;
(6) Information on investment, import and export trade, etc. between the foreign invested enterprise and the foreign investor and its affiliated parties in the preceding year; and
(7) Material litigation, administrative reconsideration, and administrative or criminal punishments involving the foreign-invested enterprise in the preceding year both at home and abroad, and complaints lodged by the foreign-invested enterprise in accordance with Chapter 8 [Coordination and handling of complaints] herein.

Where the investment in Mainland China by a foreign investor does not involve the establishment or change of a foreign-invested enterprise, the foreign investor shall, by April 30 each year, submit an annual report which shall cover the information specified in Item (1) and Item (2) of the preceding Paragraph, as well as the transactions and returns on investment assets in the preceding year.
The relevant competent foreign investment department may require the foreign investor or the foreign-invested enterprise to make supplementary submissions of materials related to the information prescribed in the preceding two paragraphs.

Article 93 [Contents of annual reports—portfolio investments]
A foreign investor that purchases less than 10% of the shares of a domestically-listed company and that does not cause changes to the control thereof shall, by April 30 each year, submit an annual report that contains the following information:

(1) The name, domicile, place of registration, actual controller, organizational form, core business, contact persons and contact details of the foreign investor;
(2) The name, ticker and business scope of the domestically-listed company; and
(3) Information on stock trading in the preceding year.

Article 94 [Quarterly reporting by key foreign-invested enterprises]
Where a foreign-invested enterprise controlled by a foreign investor has total assets, sales revenue or operating revenue exceeding RMB 10 billion, or has over ten subsidiaries, the foreign-invested enterprise shall, within 30 days following the end of each quarter, report its quarterly operating conditions and financial and accounting information.

Article 95 [Integrated reporting]
A foreign-invested enterprise shall submit reports after integrating relevant information on the domestic enterprises directly or indirectly controlled thereby.

Section 5: Foreign Investment Statistics Work

Article 96 [Foreign investment statistics work]
The competent foreign investment department of the State Council shall, pursuant to the Statistics Law and relevant provisions of the State, establish and improve a

foreign investment statistical survey system and statistical standards, organize, coordinate and manage foreign investment statistical survey work nationwide, conduct statistical analysis in light of the information reported by foreign investors and foreign-invested enterprises, publish statistical data, and properly carry out archives management, data and information sharing and exchange with external parties.

Article 97 [Statistical reports]
The competent foreign investment department of the State Council shall collate and summarize relevant contents contained in the information reports submitted by foreign investors and foreign-invested enterprises, and prepare and publish foreign investment statistical reports.

Article 98 [Obligations to provide information]
The competent foreign investment department of the State Council may, during foreign investment statistics work, require relevant regions and departments to provide pertinent information and data pursuant to the law, and the regions and departments concerned shall provide cooperation.

Article 99 [Sharing of statistical data]
The competent foreign investment department of the State Council shall provide foreign investment statistical data for other relevant departments pursuant to the law.

Chapter 6: Investment Promotion

Article 100 [Investment promotion mechanism]
The State shall formulate foreign investment development strategies, and establish and improve the foreign investment promotion mechanism to guide foreign investment to meet the needs of China's national economic and social development, and improve the quality and level of foreign investment utilization.

Article 101 [Investment promotion policies] The State shall formulate policy measures in terms of fiscal management, taxation, finance, human resources, industry, training, R&D and other aspects pursuant to the law to promote foreign investment.

Article 102 [Regional and industry-specific policies]
The State shall, according to domestic economic and social development and the needs of industry transfer, promote foreign investors to invest and establish foreign invested enterprises with advantages in products, services or technologies in industries encouraged by the State, and special economic zones, ethnic autonomous regions and economically underdeveloped regions.

Article 103 [Investment promotion services]
The State shall establish a public service system for foreign investment to provide foreign investors and other members of the public with investment promotion services in terms of laws and regulations, policy measures, investment projects and information, etc. that are related to foreign investment.

Article 104 [Investment promotion order]
The State shall promote the establishment of a reasonable and standardized investment promotion order.
It is prohibited to encourage foreign investment by ways that are detrimental to national security, public interests, people's life and health, ecological environment, labor rights and interests, etc.

Article 105 [International investment promotion agency]
The State shall support an international investment promotion agency to organize and carry out activities to promote foreign investment. The international investment promotion agency shall perform the following duties under the guidance of the competent foreign investment department of the State Council:

(1) To implement the strategic planning and policy measures of the State on foreign investment;
(2) To establish and implement the national investment environment evaluation system;
(3) To establish a national foreign investment public information, projects and consulting services platform;
(4) To carry out national investment promotion activities and investment promotion training;
(5) To establish overseas representative offices for investment promotion;
(6) To engage in exchange and cooperation with the investment promotion agencies of other countries or regions and international investment promotion organizations; and
(7) To accept and coordinate the handling of complaints from foreign investors, and help safeguard the legitimate rights and interests of foreign investors and foreign invested enterprises.

Article 106 [International investment exchange platform]
The international investment promotion agency shall organize and establish international investment exchange platforms to promote and facilitate cross-border investment.

Article 107 [Investment information websites and databases]
The international investment promotion agency shall set up and improve international investment promotion websites and international investment project databases.

Article 108 [Local investment promotion]
The State encourages all regions to set up and consummate international investment promotion mechanisms, and establish special investment promotion agencies.

Article 109 [Special economic zones]
The State Council may set up special economic zones to promote foreign investment and expand liberalization.

Article 110 [Management of special economic zones]
The competent foreign investment department of the State Council and other relevant competent departments shall guide, serve and manage special economic zones according to their respective responsibilities.

Chapter 7: Investment Protection

Article 111 [Expropriation]
Except under special circumstances, the State shall not expropriate foreign investment.
Where it is necessary to expropriate foreign investment for public interests, the State shall conduct expropriation according to statutory procedures, and make compensation in accordance with the law.

Article 112 [Requisition]
Due to rescue, disaster relief or other urgent needs, the real estate assets or moveable assets of foreign investors and foreign-invested enterprises within Mainland China may be requisitioned in accordance with the authority and procedures prescribed by law.
Where the real estate assets or moveable assets of foreign investors and foreign invested enterprises within Mainland China are requisitioned, reasonable use fees shall be paid in accordance with the law. The requisitioned real estate assets or movable assets shall be returned to the relevant foreign investors and foreign invested enterprises after their use. Compensation shall be made in accordance with the law for the damage or loss, if any, of the requisitioned real estate assets or movable assets.

Article 113 [State compensation]
Where State organs and their staff members cause losses to foreign investors or foreign-invested enterprises by exercising authority in violation of the law, the affected foreign investors or foreign-invested enterprises shall be entitled to claim compensation pursuant to the law.

Article 114 [Transfer]
Unless otherwise prescribed by laws and administrative regulations, the State allows the free inflow and outflow of the capital contribution, profits, asset disposal incomes, lawfully obtained compensations or damages and other lawful assets of foreign investors.

Article 115 [Transparency]
The State shall promptly publish laws, regulations and judicial judgments relating to foreign investment pursuant to the law.
Foreign investors and foreign-invested enterprises may participate in the formulation of laws and regulations, and raise opinions and comments pursuant to the law.

Article 116 [Intellectual property rights protection]
The State protects the intellectual property rights of foreign investors and foreign invested enterprises in accordance with the law.

Article 117 [Chambers of commerce and industry associations]
Foreign investors and foreign-invested enterprises may establish chambers of commerce and industry associations pursuant to the law, voluntarily join such chambers and associations, and carry out relevant activities within the scope prescribed by laws, regulations and the articles of association of relevant organizations, so as to protect their own rights and interests.

Article 118 [Dispute resolution]
The disputes, if any, encountered by foreign investors during investment and business activities within Mainland China may be resolved by negotiation, mediation, lodging complaints, applying for reconsideration, arbitration or litigation and other means in accordance with relevant laws and regulations.

Chapter 8: Coordination and Handling of Complaints

Article 119 [Complaint coordination and handling mechanism]
The State shall establish a coordination and handling mechanism for foreign investment complaints which shall be responsible for the coordination and handling of the investment disputes between foreign investors and foreign-invested enterprises on the one hand and administrative organs on the other hand.

Article 120 [Responsibilities of the complaint coordination and handling center]
The international investment promotion agency shall set up a national foreign investment complaint coordination and handling center which shall coordinate and handle foreign investment complaints of significant influence across the country, and perform the following duties:

(1) To accept and forward foreign investment complaints;
(2) To coordinate with relevant regions and departments to handle foreign investment complaints;
(3) To supervise and inspect the implementation of the handling solutions for foreign investment complaints;
(4) To raise suggestions to relevant regions and departments on fine-tuning policies and improving work according to the specific situations of foreign investment complaints; and
(5) To study and analyze foreign investment complaints, and submit reports to the competent foreign investment department of the State Council.

Article 121 [Request for assistance]
According to the needs for the coordination and handling of foreign investment complaints, the national foreign investment complaint coordination and handling center may request relevant regions and departments to explain situations, submit materials and provide other necessary assistance.

Article 122 [Coordination and handling suggestions]
Where the national foreign investment complaint coordination and handling center raises suggestions to relevant regions and departments under Article 120 [Responsibilities of the complaint coordination and handling center] herein, the

relevant regions and departments shall deal with relevant situations and provide timely feedback.

Article 123 [Complaint coordination and handling agencies]
Local people's governments at and above the county level shall, according to actual needs, set up foreign investment complaint coordination and handling agencies which shall accept, and coordinate and handle the complaints lodged by foreign investors and foreign-invested enterprises against administrative organs during investment disputes within their respective jurisdictions, and shall be responsible for handling the complaints forwarded thereto by the national foreign investment complaint coordination and handling center.

Article 124 [Principles for complaint coordination and handling]
Foreign investment complaint coordination and handling agencies shall coordinate and handle complaints by following the principles of fairness, impartiality and legality, and in accordance with this Law and other relevant laws and regulations.

Article 125 [Truthfully lodging complaints]
Foreign investors and foreign-invested enterprises shall truthfully reflect relevant situations and provide corresponding evidence when lodging complaints, and cooperate with foreign investment complaint coordination and handling agencies in their work.

Chapter 9: Supervision and Inspection

Article 126 [Supervision and inspection]
Competent foreign investment departments shall strengthen the supervision and inspection of the compliance of foreign investors and foreign-invested enterprises with this Law.
Other administrative departments in charge of industry and commerce, taxation, foreign exchange, audit, etc. shall perform supervision and inspection functions pursuant to the law.

Article 127 [Launching supervision and inspection]
A competent foreign investment department may launch supervision and inspection of foreign investors and foreign-invested enterprises under any of the following circumstances:

(1) Regular inspection by spot checks;
(2) Inspection according to tip-offs;
(3) Inspection according to the suggestions raised, and situations reported, by relevant departments or judicial organs; or
(4) Inspection otherwise launched ex officio.

Article 128 [Inspection by spot checks]
Inspection by spot checks shall be divided into non-specific inspection by spot checks and targeted inspection by spot checks.
Non-specific inspection by spot checks shall mean that a competent foreign investment department randomly determines the parties and the matters to be

inspected. Targeted inspection by spot checks shall mean that a competent foreign investment department randomly determines the parties to be inspected according to the type, business scale, industry, geographical regions and other specific conditions of foreign investment.

Article 129 [Lodging tip-offs]
Any entity or individual shall be entitled to lodge tip-offs against alleged violations of this Law to competent foreign investment departments.
Whistleblowers may require competent foreign investment departments to keep confidential their information.

Article 130 [Verification of tip-offs]
A whistleblower shall provide its basic information, the basic information of the party against whom the tip-off is lodged, and relevant facts and evidence of the alleged violations of this Law.
The relevant competent foreign investment department shall conduct verification if it deems verification necessary.

Article 131 [Aspects subject to inspection]
Inspection shall cover the following aspects:

(1) Whether a foreign investor has invested in a field specified in the list of prohibited investment;
(2) Whether a foreign investor has invested in a field specified in the list of restricted investment without first obtaining licensing;
(3) Whether a foreign investor has complied with the additional conditions attached to the relevant market access licensing decision;
(4) Whether a foreign investor has complied with the restrictive conditions attached to the relevant national security review decision;
(5) Whether a foreign investor has performed information reporting obligations;
(6) Whether a foreign investor has complied with the administrative punishment decision made by the relevant competent foreign investment department;
(7) Whether a foreign investor has committed any acts detrimental to national security and public interests; and
(8) Whether a foreign investor has otherwise violated this Law.

Article 132 [Inspection methods]
Competent foreign investment departments may conduct inspection by online monitoring, questionnaire survey, field verification and other means.

Article 133 [Field verification]
When a competent foreign investment department carries out field verification, there shall be at least two inspection officers who shall produce certificates during inspection. The inspection officers shall fill out the field verification sheet, faithfully record verification situations, and have the said sheet signed or sealed by the enterprise or personnel inspected. Where such signatures or seals are unable to be obtained, the inspection officers shall note down the reasons therefor, and may, where necessary, invite relevant persons to serve as witnesses.

Article 134 [Professional conclusions]
According to inspection needs, a competent foreign investment department may entrust accounting firms, tax firms, law firms and other professional institutions to provide capital verification, audit, assurance, consulting and other professional services.
Competent foreign investment departments may adopt the inspection and verification results issued by other government departments.

Article 135 [Cooperating with inspection]
A competent foreign investment department may access, or require the party under inspection to provide, relevant materials pursuant to the law during inspection, and the party under inspection shall truthfully provide relevant materials.

Article 136 [Inspection discipline]
During inspection, competent foreign investment departments may not hinder the normal production and operation activities of the parties under inspection, may not accept valuables or services provided by the parties under inspection, and may not seek for other illegal benefits.

Article 137 [Inspection handling]
Where it is found during inspection that the party under inspection may have violated this Law, the relevant competent foreign investment department may carry out investigation in accordance with the law, and shall mete out punishments pursuant to Chapter 10 [Legal liabilities] herein if illegalities are confirmed upon investigation.

Article 138 [Information sharing]
Competent foreign investment departments and other relevant competent administrative departments shall share information on foreign investment management.

Article 139 [Local inspection]
The competent foreign investment department of the State Council shall be responsible for guiding foreign investment supervision and inspection at the national level, and shall carry out, or organize local competent foreign investment departments to carry out inspection according to actual needs.
Competent foreign investment departments of local people's governments at and above the county level shall be responsible for organizing or carrying out foreign investment inspection within their respective jurisdictions.

Article 140 [Guidance and supervision of local inspection]
Superior competent foreign investment departments shall strengthen guidance and supervision of subordinate competent foreign investment departments in their inspection work, and promptly correct relevant illegalities.

Article 141 [Integrity files]
The competent foreign investment department of the State Council shall establish a foreign investment integrity file system.

Information recorded in the foreign investment integrity file system shall include information generated during the establishment registration, production and operation, and other activities of foreign investors and foreign-invested enterprises, and information reflecting the integrity of foreign investors and foreign-invested enterprises that is obtained by competent foreign investment departments and other competent departments during supervision and inspection.
Specific measures for management of the foreign investment integrity file system shall be separately prescribed by the State Council.

Article 142 [Disclosure of integrity information]
A competent foreign investment department may, pursuant to the law, make public the integrity information of foreign investors and foreign-invested enterprises.
The public may apply for inquiring about the integrity information of foreign investors and foreign-invested enterprises.
Integrity information made public or disclosed to other parties in accordance with the preceding two paragraphs shall not contain the trade secrets and personal privacy of foreign investors and foreign-invested enterprises, unless otherwise prescribed by laws and administrative regulations.

Article 143 [Modification and correction of integrity information]
Foreign investors and foreign-invested enterprises may inquire about their own integrity information recorded in the foreign investment integrity file system, and may provide relevant supporting materials to apply for modification or correction if they are of the opinion that relevant information records are incomplete or erroneous.
Modification and correction shall be made if such incompleteness or errors are verified as true.

Chapter 10: Legal Liabilities

Article 144 [Investing in fields specified in the list of prohibited investment]
Where a foreign investor invests in a field specified in the list of prohibited investment, the competent foreign investment department of the people's government of the province, autonomous region or municipality directly under the Central Government at the place of investment shall order the foreign investor to stop the investment and dispose of equities or other assets within the prescribed time period, confiscate its illegal gains, and concurrently impose on the foreign investor a fine of not less than RMB 100,000 but not more than RMB 1 million, or a fine of up to 10% of the amount of illegal investment.

Article 145 [Violating provisions on market access licensing]
Where a foreign investor invests in a field specified in the list of restricted investment without first obtaining licensing, the competent foreign investment department of the people's government of the province, autonomous region or municipality directly under the Central Government at the place of investment shall order the foreign investor to stop the investment and dispose of equities or other assets within the prescribed time period, confiscate its illegal gains, and

concurrently impose on the foreign investor a fine of not less than RMB 100,000 but not more than RMB 1 million, or a fine of up to 10% of the amount of illegal investment.
Where a foreign investor breaches the additional conditions attached to the market access licensing decision on its foreign investment, the competent foreign investment department that makes the licensing decision shall order the foreign investor to make correction within the prescribed time period, and concurrently impose thereon a fine of not less than RMB 50,000 but not more than RMB 500,000, or a fine of up to 5% of the investment amount. Where the foreign investor fails to correct by the prescribed deadline or falls under grave circumstances, the competent foreign investment department may revoke its market access licensing.

Article 146 [Violating provisions on national security review]
Where a foreign investor falls under any of the following circumstances, the competent foreign investment department of the State Council shall order the foreign investor to make correction within the prescribed time period, impose thereon a fine of not less than RMB 100,000 but not more than RMB 1 million, or a fine of up to 10% of the investment amount, and may request for another round of national security review pursuant to Article 56 [Conducting another round of national security review] herein:

(1) Where the foreign investor conceals relevant situations, provides false materials or makes false statements during national security review; or
(2) Where the foreign investor breaches the restrictive conditions attached to the relevant national security review decision.

Article 147 [Administrative legal liabilities for violating information reporting obligations]
Where a foreign investor or foreign-invested enterprise violates this Law, and fails to perform information reporting obligations as scheduled or evades the performance of such obligations, or conceals true situations or provides false or misleading information during information reporting, the competent foreign investment department of the people's government of the province, autonomous region or municipality directly under the Central Government at the place of investment shall order the foreign investor or foreign-invested enterprise to make correction within the prescribed time period, and shall impose thereon a fine of not less than RMB 50,000 but not more than RMB 500,000, or a fine of up to 5% of the investment amount if the foreign investor fails to correct by the prescribed deadline or falls under grave circumstances.

Article 148 [Criminal legal liabilities for violating information reporting obligations]
Where a foreign investor or foreign-invested enterprise falls under extraordinarily grave circumstances by evading the performance of information reporting obligations, or by concealing true situations or providing false or misleading information during information reporting in violation of this Law, the entity concerned shall be sentenced to fines, while the person-in-charge subject to direct liabilities and other

personnel subject to liabilities shall be sentenced to fixed-term imprisonment of one year or less or criminal detention.

Article 149 [Legal liabilities for circumventing the compliance with this Law]
Where a foreign investor or foreign-invested enterprise circumvents this Law by agency holding, trust, multi-level re-investment, leasing, contracting, financing arrangements, agreement-based control, overseas transactions or any other means, and invests in a field specified in the list of prohibited investment, or invests in a field specified in the list of restricted investment without first obtaining licensing, or violates the information reporting obligations prescribed herein, the foreign investor or foreign-invested enterprise shall be punished respectively in accordance with Article 144 [Investing in fields specified in the list of prohibited investment], Article 145 [Violating provisions on market access licensing], Article 147 [Administrative legal liabilities for violating information reporting obligations] or Article 148 [Criminal legal liabilities for violating information reporting obligations] herein.

Article 150 [Compulsory enforcement measures]
Where a foreign investor or foreign-invested enterprise fails to perform the administrative punishment decision made by the relevant competent foreign investment department within the prescribed time period, the said department may take the following measures:

(1) Imposing late fines at 5% of the amount of fine per day if the foreign investor or foreign-invested enterprise fails to pay the fine by the due date;
(2) Auctioning off the assets sealed off or seized, or transferring the deposits frozen to offset fines pursuant to the law; or
(3) Applying to a competent people's court for compulsory enforcement.

Article 151 [Revoking licenses and criminal legal liabilities]
Where foreign investors or foreign-invested enterprises violate this Law, relevant competent industry departments may revoke their licenses pursuant to the law, and relevant administrations for industry and commerce may revoke the business licenses of the foreign-invested enterprises in accordance with the law; and, where criminal offenses are constituted, the foreign investors or foreign-invested enterprises shall be investigated for criminal liabilities pursuant to the law.

Article 152 [Legal liabilities of the staff members of management departments]
The staff members of competent foreign investment departments and other relevant management departments shall be given administrative sanctions pursuant to the law if they practice favoritism for personal gains, abuse power or neglect duties during the performance of duties, and shall be investigated for criminal liabilities pursuant to the law if criminal offenses are constituted.

Chapter 11: Supplementary Provisions

Article 153 [Enterprises in existence prior to the effective date hereof]
Foreign-invested enterprises that are in lawful existence prior to the effective date hereof shall be governed by this Law, unless otherwise prescribed in this Chapter.

Article 154 [Changes of enterprises in existence prior to the effective date hereof]
Where a foreign-invested enterprise in lawful existence prior to the effective date hereof changes operating matters after this Law comes into effect, the foreign invested enterprise shall apply for market access licensing if it falls under any of the circumstances prescribed herein where market access licensing shall be applied for.
A foreign-invested enterprise in lawful existence prior to the effective date hereof shall apply for market access licensing if it newly increases the amount of investment after this Law comes into effect and therefore reaches the relevant threshold prescribed in the list of restricted investment.

Article 155 [Continuing operations under original conditions]
A foreign-invested enterprise in lawful existence prior to the effective date hereof may continue its operations under the business scope, operating period and other conditions originally approved.

Article 156 [Operating period]
After this Law comes into effect, the parties to an investment may agree on the operating period at their discretion, except where a competent foreign investment department lists the operating period as a market access condition in accordance with this Law.
Where the operating period of an investment expires during the period after the promulgation but before the effective date hereof, and the parties to the investment intend to continue operation, they may go through the formalities for change with the relevant administration for industry and commerce after this Law comes into effect.
Where the parties to an investment prejudice the rights and interests of a third party by agreeing on the operating period at their discretion or changing the operating period, the third party may claim its rights pursuant to relevant laws and regulations.

Article 157 [Changing the organizational forms and organizational structures of enterprises]
A foreign-invested enterprise in lawful existence prior to the effective date hereof shall, within three years after this Law comes into effect, change its organizational form and organizational structure pursuant to the Company Law, the Law on Partnership Enterprises, the Law on Sole Proprietorship Enterprises and other relevant laws and regulations, provided that the said enterprise shall make relevant changes within its current operating period if the current operating period expires within three years after this Law comes into effect and the said enterprise intends to extend its operating period.
Before changes are completed in accordance with the preceding Paragraph, the provisions on the organizational forms and organizational structures of enterprises prescribed by the Law on Sino-foreign Equity Joint Ventures, the Law on Foreign invested Enterprises and the Law on Sino-foreign Contractual Joint Ventures shall continue to apply.

Article 158 [Handling of agreement-based control]
Please refer to the Notes on the Foreign Investment Law of the People's Republic of China (Draft for Comments).

Article 159 [Obtaining foreign citizenship]
Once a natural person of Chinese nationality obtains foreign citizenship, his/her investment in Mainland China shall be foreign investment regardless of whether such investment is made before or after the effective date of this Law, and shall therefore be governed by this Law, unless otherwise stipulated by the State Council.

Article 160 [Obtaining foreign permanent residency]
Where natural persons of Chinese nationality obtain foreign permanent residency, the provisions otherwise prescribed by relevant laws and administrative regulations on the treatment of their investments in Mainland China shall prevail.

Article 161 [Obtaining Mainland permanent residency]
Where natural persons of foreign citizenship obtain Mainland permanent residency, the provisions otherwise prescribed by relevant laws and administrative regulations on the treatment of their investments in Mainland China shall prevail.

Article 162 [Investment by Taiwanese compatriots]
Unless otherwise prescribed by laws and administrative regulations, this Law shall apply, mutatis mutandis, to investments in Mainland China by Taiwanese compatriots.
Special treatment of investments in Mainland China by Taiwanese compatriots shall be separately prescribed by the State Council.

Article 163 [Investment by Hong Kong and Macao compatriots and overseas Chinese]
Unless otherwise prescribed by laws and administrative regulations, this Law shall apply, *mutatis mutandis*, to investments in Mainland China by Hong Kong and Macao compatriots and overseas Chinese.
Special treatment of investments in Mainland China by Hong Kong and Macao compatriots and overseas Chinese shall be separately prescribed by the State Council.

Article 164 [Application of law]
Investment contracts signed by foreign investors that are to be performed in Mainland China shall be governed by Chinese laws.

Article 165 [Countermeasures]
Where any country or region takes discriminatory measures against Chinese investors and their investments, the State may take appropriate measures in response according to actual situations.

Article 166 [Foreign investment in the financial sector]
Where foreign investors invest in banking, securities, insurance and other financial fields, relevant competent financial departments shall conduct market access

licensing, and supervision and inspection, in accordance with pertinent laws and administrative regulations.

Article 167 [Denominated currency]
Foreign investment management and statistics shall mainly be denominated in RMB.

Article 168 [Whether the given figure is included]
For the purpose of this Law, the expressions of "以上" (literally "more than"), "以下" (literally "less than") and "达到" (literally "reach") shall include the given figure, while the expressions of "超过" (literally "exceed"), "少于" (literally "less than") and "不足" (literally "less than") shall not include the given figure.

Article 169 [Implementing measures]
The State Council may formulate implementing measures in accordance with this Law.

Article 170 [Effective date]
This Law shall come into effect on MM DD, 20XX. The Law on Sino-foreign Equity Joint Ventures, the Law on Foreign-invested Enterprises and the Law on Sino-foreign Contractual Joint Ventures shall be simultaneously repealed.

Final Remarks

We trust that this text has been helpful in clarifying some aspects of corporate governance in China and will serve as a useful practical reference for companies operating in China and investors contemplating the establishment of a FIE.

This book, whilst not intended to examine the law in an academic manner, has provided analysis of the current and proposed Draft Laws, in order to inject clarity into the context surrounding Foreign-Investment. As a result, we have sort to write this rather as a guide for handling company issues on a daily basis, ranging from the simplest activities to the most complex operations. To do this, we examined company structures along with their functions, relevant liabilities, roles and obligations of their personnel and the overarching Governmental Authority structure.

As we have seen, there are still no stringent rules in regards to the possibility of opposing any third party decisions made by the legal representative against the will of the board of directors or of the board of shareholders, or any decisions made by the general manager using the Company Chop outside the scope of his powers.

The instruments of protection are therefore mainly and necessarily aimed at obtaining damages compensation, except for the case of obviously fraudulent acts and void acts, regardless of the fact that the interested party knew or not the ultra vires nature of the relevant operations.

It is, therefore, advisable in general to establish a clear system of delegations and liabilities towards the managers that must handle company operations, and in any event to constantly maintain control over such operations, regardless of the fact that PRC law makes such control mandatory or not.

It is good practice for officials at least once a year during meetings to take minutes of the board of directors or the board of shareholders. This is recommended as it ensures that there is a written record of company decisions. Furthermore, it provides the manager with the management path that they are required to follow, resulting in better accountability for their decisions and actions in future, as well as coherence within the organs of the company.

It is moreover advisable to organize constant control on the accounting and administrative aspects of the company with the help of local professionals.

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G. Pisacane, *Corporate Governance in China*, China Law,
Tax & Accounting, DOI 10.1007/978-981-10-3911-9

For those companies that have the possibility to do so without excessively hampering company operations, it is definitely useful and safe to entrust a third party with the handling of company seals, or in any event to arrange for their disjoint handling.

For example, one may stipulate in the articles of association (and, therefore, opposable to third parties) that certain decisions necessarily require the company chop and the signature of the legal representative. This method is convenient where the legal representative is an individual tie to the foreign investor and does not actually run the company in China on a day-by-day basis.

On the other hand, where the legal representative is the same person operating on the field and responsible for the management of the company in China (and, usually, also with the handling of company seals), at that point the only protection instruments will be a rigid system of delegations and damages liabilities to entrusting third-party counsellors to keep company seals.

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G. Pisacane, *Corporate Governance in China*, China Law,
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